

1 SanFrancisco.txt  
2 SIZE STANDARDS HEARING  
3 SMALL BUSINESS ADMINISTRATION DISTRICT OFFICE  
4 455 MARKET STREET, 6TH FLOOR  
5 SAN FRANCISCO, CALIFORNIA  
6  
7  
8  
9  
10  
11  
12 TRANSCRIPT OF PROCEEDINGS RE:  
13 SIZE STANDARD HEARING  
14 TUESDAY, JUNE 28, 2005  
15  
16  
17  
18  
19  
20  
21 BEHMKE REPORTING & VIDEO SERVICES  
22 BY: KATHERINE A. POWELL, CSR #5812, CRR  
23 1320 ADOBE DRIVE  
24 PACIFICA, CALIFORNIA 94044  
25 (650) 359-3201

1

1 PANEL APPEARANCES:  
2 MARK QUINN, DISTRICT DIRECTOR, SBA SAN FRANCISCO  
3 BRUCE THOMPSON, REGIONAL ADMINISTRATOR, SBA  
4 SAN FRANCISCO  
5 GARY JACKSON, ASSISTANT ADMINISTRATOR, WASHINGTON SBA  
6 JOHN KLEIN, OFFICE OF GENERAL COUNSEL

7 BOB PACCIONE, AREA DIRECTOR, OFFICE OF GOVERNMENT

8 CONTRACTING SAN FRANCISCO

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1 TUESDAY, JUNE 28, 2005; 8:30 A.M.

2

2

3 MR. QUINN: We're going to get an early start in  
4 consideration for all. First off, I would like to  
5 welcome everyone here. My name is Mark Quinn, I'm the  
6 district director of the San Francisco Small Business  
7 Administration. And I would like to welcome all of you  
8 here for the size standard hearings.

9 I would like to introduce some of the folks on  
10 the panel here. Bruce Thompson, my boss, is the  
11 regional administrator. Gary Jackson is from SBA in  
12 Washington. He's in charge of size standards. John

13 Klein is also from Washington, from the Office of  
14 General Counsel, and Bob Paccione is the area director  
15 for the Office of Government Contracting here in  
16 San Francisco.

17 I'd like to welcome you here. I would like to  
18 also, for logistics point of view, let you understand  
19 the restrooms are out of this room here, in the hallway.  
20 We're going to be holding this session from 8:30 until  
21 12:30. Is that correct? And then a break, and then  
22 have another session that picks up from 12:30 until  
23 5:30.

24 We're really looking forward to all of your  
25 testimony and all the things you have to say. I'm sure

1 that all of you came so early with good ideas and strong<sup>3</sup>  
2 opinions.

3 When it comes to size standards, we at SBA in  
4 San Francisco -- some people know this, of course, but  
5 we have our own size standards, and that is for our  
6 definition, Gary, for small business, you are a small  
7 business if in a pinch you can take your dog to work.  
8 So we're plugging for one of you to pitch that as the  
9 recommendation for the way we should set size standards  
10 at SBA.

11 For us, we would like to be able to have all  
12 of you get the opportunity to testify. So without any  
13 further ado, let me introduce Bruce Thompson, regional  
14 administrator.

15 MR. THOMPSON: Thank you, Mark. You are all going  
16 to stay awake. Mark made sure this room was nice and  
17 chilly. Nobody is going to fall asleep in here.

18 Good morning and welcome to the San Francisco

19 size standard hearing. I'm Bruce Thompson, the SBA  
20 regional administrator serving the states of California,  
21 Nevada, Arizona, Hawaii and Guam. Yes, somebody has to  
22 go out to Hawaii.

23           Within this area we have nine district offices  
24 and one branch office. The mission of the SBA is to  
25 maintain and strengthen the national economy by aiding,

1           counseling, assisting, protecting the interests of small<sup>4</sup>  
2 businesses, and by helping families and small businesses  
3 recover from natural disasters.

4           Size standards is the fundamental issue of the  
5 SBA, since it determines which businesses are eligible  
6 for the SBA assistance, small business preference,  
7 federal contracts, small business assistance for many of  
8 the federal programs and regulations.

9           The purpose of today's hearing is to hear you  
10 on the issues of size standards, in particular on the  
11 ways SBA might simplify size standards and other ideas,  
12 to make standards easier to understand and use.

13           The testimony presented today on size  
14 standards, along with other comments and testimony  
15 received December of 2004, Advance Notice of Proposed  
16 Rulemaking, will be used to help SBA make new proposals  
17 to further these objectives.

18           On behalf of myself, Administrator Hector  
19 Gurardo, we thank you for taking the time out of your  
20 busy schedules to be here on this very important issue.

21           I will now turn the time over to John Klein,  
22 the moderator, who will introduce the panelists, I  
23 guess, which has already been done, John, and go over  
24 the rules of the hearing. John.

SanFrancisco.txt  
25 MR. KLEIN: Thank you, Bruce.

1 Again, this is the hearing to understand  
2 comments you may have regarding size, generally.

3 On March 19, 2004, SBA proposed a  
4 restructuring of the size standards. There were more  
5 than 4,000 comments in response to that proposal.

6 In response to that proposal, we decided to  
7 pull back the rule. And on July 1st, 2004, we withdrew  
8 that proposal. So at the present time, there is no SBA  
9 proposal out there on the streets.

10 In response to that proposal, again, we issued  
11 an Advance Notice of Proposed Rulemaking. What that  
12 means is we received comments from the public on the  
13 previous one, and these are the issues that the public  
14 said are important to them.

15 we identified those issues in the Advance  
16 Notice of Proposed Rulemaking, and those are the issues  
17 we identified to you to talk about, and other issues  
18 regarding how size should be simplified generally.

19 So again, at the present time there is no SBA  
20 proposal out there on the streets. There is just --  
21 these are the issues presented by the public, and we ask  
22 you to comment on them.

23 Your testimony will be recorded today by a  
24 court reporter. When you get to the podium, please  
25 state your name and spell it for the record, and any

1 organization or firm that you represent. The names will<sup>6</sup>  
2 be called in the order listed on the registration docket  
3 that we have. If an individual is not present when  
4 called, he or she will be called again before the end of  
5 the hearing.

6           Each presenter will be allowed five minutes  
7 for an oral presentation. I will advise you when your  
8 time is up. In fact, Bob Paccione will hold up a little  
9 one-minute-to-go sign. You are in the high-tech  
10 San Francisco area.

11           When you finish your presentation, you may  
12 give us any hard copy of the presentation, if you like.  
13 That's not necessary, but if you have it, please feel  
14 free to do so.

15           Members of the panel will ask you questions  
16 depending upon what you say and what -- in terms of  
17 trying to understand your position more fully.

18           The panel will not respond as to whether it  
19 agrees or disagrees with a position presented, just  
20 trying to understand more of your position.

21           With that, let's just get started. The first  
22 person will be Isiah Harris.

23           MR. HARRIS: Yes. I am Isiah Harris, I-s-i-a-h  
24 H-a-r-r-i-s. I am the president of Ameritac, Inc. and  
25 also the president of the Northern California 8(a)

1 Association.

2           Ameritac, Inc. is an 8(a)certified facility  
3 support services and construction company, and as a  
4 small disadvantaged business owner I appreciate this  
5 opportunity to testify before the panel today.

6           As I indicated, I also represent the Northern  
7 California 8(a) Association, and the association  
8 represents the largest group of 8(a) companies outside  
9 of the Washington, D.C. area. We have over 300 firms  
10 that provide a wide variety of services to the federal,  
11 state and local governments.

12           The SBA, in its notice of May, asked for a  
13 series of questions to be responded to, and my following  
14 statement will attempt to address these issues. But in  
15 general, I remain deeply concerned over the proposed  
16 size standard changes.

17           The SBA should make every effort to equitably  
18 address the needs of small businesses before making any  
19 changes. Unless the changes made by the SBA reflect a  
20 significant improvement in the number and values of  
21 contracts awarded to small businesses, any changes to  
22 the current small business size standards appear to be  
23 counterproductive and in direct conflict with the  
24 mission of the SBA and, as I understand it, the Bush  
25 administration policies.

1           The current system is not complex or difficult<sup>8</sup>  
2 to use and, therefore, should not be changed. While  
3 there are size standards that currently use the number  
4 of employees for the size standard, these are primarily  
5 in the manufacturing and wholesale industries.

6           The service contracting industry is a  
7 different ballgame. The majority of businesses are  
8 based on revenue. Moving to an employee-based standard  
9 for these firms would not constitute a simplification.  
10 It creates additional paperwork burdens on these small  
11 businesses. This is a tremendous burden for me and the  
12 other 4.4 million small firms here.

13           Imposing a receipt cap in addition to the  
14 employee-based standard simply would add unnecessary  
15 complexity to the system.

16           The main concern for me as a small business  
17 owner is that size standards be reviewed annually, and

18 adjusted for inflation, possibly using a commonly  
19 accepted index such as the Consumer Price Index. I  
20 believe the issue of regularly updated size standards  
21 must be addressed to enhance growth among the nation's  
22 small businesses.

23 In 1997, the SBA considered converting all  
24 standards to employee base, and rejected it. To date, I  
25 have not seen much reason to change that. I believe

1 changing the standards will have a disastrous effect on<sup>9</sup>  
2 literally thousands of small businesses, such as mine,  
3 that have used the receipt-based system in good faith,  
4 not expecting the government to make a radical change  
5 that could potentially ruin our companies overnight.  
6 I'm also concerned about collateral impacts on moving to  
7 an employee-based standard for all small businesses.

8 while not advocating moving to an  
9 employee-based system, I suggest that the SBA consider  
10 the following if there is a move in that direction:

11 One, because the revenue-based size standard  
12 is calculated on an average over a three-year period,  
13 that that same approach should be taken to calculate the  
14 number of employees.

15 Two, the term "employee" should be changed to  
16 "full-time equivalent" with a specific number of hours  
17 associated to such an employee.

18 Now, there are a number of programs that the  
19 SBA size standard would apply to, and one is certainly  
20 dealing with the 8(a) contract, of which I am one, and  
21 as I said represent a number of such.

22 The requirements right now is that for every  
23 8(a) contract, the SBA has to review that contract prior



24 to the award to the 8(a) firm. Under the current system  
25 with the revenue base, that only has to be done once a  
1 year. On the employee base, it would have to be done <sup>10</sup>  
2 every 52 weeks. That's a tremendous amount of work for  
3 the SBA and the reduced staffing requirement, for them  
4 to be able to implement.

5 The proposed rules make the small business  
6 smaller, unstable and, thus, unable to compete with  
7 large businesses when no longer classified as a small  
8 business.

9 Thanks for allowing me this time.

10 MR. KLEIN: Now, under the proposal that you first  
11 talked about, the March 2004, when we proposed  
12 employees, would your business have been reclassified as  
13 other than small in that proposal?

14 MR. HARRIS: In a significant number of the NAIC  
15 codes, yes.

16 MR. KLEIN: You said it was more complicated for  
17 you in terms of paperwork. Would you have a system in  
18 place that could handle the turnover, if that was the  
19 case? Or it would be more of a burden on your business,  
20 is that what you're saying?

21 MR. HARRIS: It would be more of a burden on my  
22 business. I do have the payroll records. But, you  
23 know, we pay biweekly. So every two weeks we'd have to  
24 be doing this job -- this week I'm a small business, a  
25 construction business, you pick up some contracts, you

1 bring in a staff temporarily, and right now the way the <sup>11</sup>  
2 process is really belly buttons (sic). So someone who  
3 works one hour, all of a sudden this pay period I'm

4 small; next pay period I'm large. I'm not manufacturing  
5 where you're out there making widgets and you've got a  
6 stable way of controlling your workforce.

7 MR. KLEIN: Okay. Thank you.

8 Next person will be Cinta Gibbons.

9 MS. GIBBONS: Cinta, C-i-n-t-a, Gibbons,  
10 G-i-b-b-o-n-s. I'm speaking on behalf of the salon  
11 Association.

12 Thank you for the opportunity to comment on  
13 the issues presented in the SBA Advance Notice of Party  
14 Rulemaking Small Business Size Standards.

15 As an industry that is primarily comprised of  
16 small, independent businesses, it is extremely important  
17 to the salon industry to maintain the existing  
18 eligibility for SBA programs and assistance.

19 In its Advance Notice of Public Rulemaking,  
20 SBA stated that it proposed restructured size standards,  
21 to simplify and make them easier to use.

22 while the application of size standards may be  
23 confusing for businesses in some industries, this has  
24 not been a problem in the salon industry.

25 The current receipts-based size standard of

1 6 million in annual sales was extremely user friendly <sup>12</sup>  
2 and easy to apply. As such, I believe that the current  
3 system of size standards would preserve the existing  
4 simplicity for the objective of small businesses in the  
5 salon industry. The salon industry is unique and should  
6 be considered separately.

7 In its proposed restructuring of size  
8 standards issued on March 19th, SBA established a  
9 50-employee size standard for nonmanufacturing

10 industries with current 6 million size standards.

11           This size standard was referred to as a  
12 nonmanufacturing anchor-size standard. Unless other  
13 criteria are present within an industry, the  
14 nonmanufacturing anchor-size standard would apply to all  
15 nonmanufacturing industries with current 6 million size  
16 standards.

17           A defining characteristic of the salon  
18 industry is the fact that it is extremely labor  
19 intensive, and its employees generating a relatively  
20 small amount of sales compared to other sectors of the  
21 economy.

22           According to data from the Census Bureau, the  
23 average receipts-per-employee ratio in the salon  
24 industry is less than 40,000 per employee, include sales  
25 per employee information. And as a result, I believe

13  
1 that it is important for the salon industry to be  
2 considered separately from nonmanufacturing sectors.

3           If SBA chooses to move forward with  
4 structuring of the size standards, in its -- SBA  
5 requested comment on a number, including the calculation  
6 of number of employees for size standard and purposes.

7           While I strongly believe that the current  
8 receipts-based system of size standards is appropriate  
9 for the salon industry, I have several concerns about  
10 the method in which SBA calculates the number of  
11 employees for a business.

12           If, in fact, SBA chose to change from a  
13 receipts-based size standard to an employee-based size  
14 standard, in particular the method of calculating  
15 employees does not apply consistently across industries.

16 Some industries, such as the salon industry, rely more  
17 heavily on part-time employees than do other industries.

18 In the application of an employee-based size  
19 standard, SBA currently calculates the number of  
20 employees of a business concern as the average number of  
21 persons employed for each pay period over the firm's  
22 last 12 months, and includes the employees of all  
23 affiliates.

24 In addition, no distinction is made between  
25 full-time, part-time and temporary employees, with

1 part-time and temporary employees counting the same as 14  
2 full-time employees.

3 The salon industry would be particularly  
4 impacted by this system. As the average number of hours  
5 worked by a salon industry employee, a typical workweek  
6 is significantly less than most other nonmanufacturing  
7 industries.

8 According to the Bureau of Labor Statistics,  
9 nonsupervisory employees in the salon industry worked an  
10 average of 26.4 hours per week in 2004. That is well  
11 below the average of 30.7 hours worked by their  
12 counterparts in other retail sectors, and 33.7 hours  
13 worked in the overall and private sector.

14 This means that compared to the vast majority  
15 of other industries, a large number of employees are  
16 needed in the labor intensive salon industry to generate  
17 a certain amount of sales. As a result, it takes many  
18 more salon employees to generate an annual sales volume  
19 that would be considered small in other industries.

20 If the goal of SBA is to make the size  
21 standards as simple and easy to use as possible, I

22 recommend a receipts-based size standard as the  
23 appropriate approach for the salon industry.

24 For small businesses such as a salon, that  
25 have a high proportion of part-time employees, it is

1 much more difficult to track the number of employees  
2 than it is to produce documentation of the total annual  
3 receipts.

4 SBA also requested comments on alternative  
5 approaches of calculating the size of a business  
6 concern. If the goal is to simplify size standards from  
7 the prospective of the business community, then  
8 establishing a size standard based on  
9 full-time-equivalent employees is definitely not the  
10 approach to take.

11 Although it would appear to be more equitable  
12 to calculate employee-based size standards on a  
13 full-time-equivalent basis rather than by counting  
14 full-time, part-time and temporary employees equally, it  
15 would simply not be feasible in practice.

16 The full-time-equivalent approach places a  
17 tremendous administrative burden on small businesses, in  
18 particular business that is subject to seasonal  
19 fluctuations and those with high proportions of  
20 part-time employees.

21 As I previously mentioned, it would be  
22 difficult enough to average the total number of  
23 employees, including full-time, part-time and temporary  
24 employees over a 12-month period. Businesses are also  
25 expected to first calculate the number of

1 full-time-equivalent employees for a pay period and then  
2 calculate --

3 MR. KLEIN: Can you wrap up. Your time is just  
4 about there. You can finish your sentence.

5 MS. GIBBONS: -- employees per pay period and then  
6 calculate an average of their pay periods over a  
7 12-month period, the administrative burden would be  
8 excessive.

9 MR. JACKSON: Ms. Gibbons, I have just one  
10 question. If SBA were to consider a  
11 full-time-equivalent calculation for number of  
12 employees, and we looked at that as maybe a one-year  
13 average calendar-year basis or fiscal-year basis, would  
14 that minimize the burden to your firm, firms in your  
15 industry?

16 MS. GIBBONS: It would be difficult for us to --  
17 that would be a difficult thing for us to put into  
18 place.

19 MR. JACKSON: Still relatively a burden for you?

20 MS. GIBBONS: Yes.

21 MR. JACKSON: Thank you.

22 MR. KLEIN: William Marshall? Patricia Meagher?

23 MS. MEAGHER: Thank you, Mr. Klein. My name is Pat  
24 Meagher, and I'm an attorney in San Francisco in private  
25 practice.

1 I am a member of Women Impacting Public  
2 Policy, a national bipartisan public policy organization  
3 which represents more than 500,000 women in business and  
4 women business owners nationwide.

5 I am also a member of the executive board of  
6 Women Construction Owners and Executives. This  
7 organization was established in 1983, to promote  
8 opportunities and businesses for women-owned firms and

9 for women executives in the construction industry.

10 In my law practice for the last 20 years, I  
11 have represented contractors involved in state, federal  
12 and local public contracting. I thank you for the  
13 opportunity to speak to you today.

14 There are six issues that I would like to  
15 address in my oral testimony today. To the extent that  
16 I run out of time, they are all addressed in full in my  
17 written testimony.

18 First, on the reduction of the number of size  
19 standards. I understand the SBA is considering reducing  
20 the size standard to ten level. Although I can  
21 appreciate that the SBA has a concern that its current  
22 regulations may be viewed as unduly complex, a reduction  
23 in the number of size standards, simply for the sake of  
24 administrative convenience, is not appropriate, nor is  
25 establishing an arbitrary maximum number of standards.

18  
1 SBA should establish as many size standards as  
2 necessary to reflect the specific characteristics of the  
3 sectors and subsectors of our economy. And I have, in  
4 fact, found the use of the industry classification  
5 system in its detailed categories very helpful in my own  
6 practice in helping clients determine the applicable  
7 size standard for their own businesses.

8 Second, with regard to the issue of annual  
9 receipts versus the employee-based standards, I myself  
10 do not favor any such change. For the service sector, I  
11 believe the annual receipts is the appropriate measure  
12 of the size of the business.

13 Many small service companies provide service  
14 or staffing needs at a customer's location. A company's

15 internal staff may be small, but its payroll would  
16 fluctuate.

17           At times the number of employees on a payroll  
18 may be relatively large, as it would include or reflect  
19 the number of individuals who are hired temporarily or  
20 for a specific customer assignment. Annual receipts  
21 appear to provide a more reasonable and more accurate  
22 measure of the size of such a business.

23           For similar reasons, as well as the fact as  
24 there are seasonal fluctuations, the construction  
25 industry would also appear to be best suited to a size

1 standard based on annual receipts rather than number of<sup>19</sup>  
2 employees.

3           And I note that the City of San Francisco,  
4 which is now re-looking at small business disadvantaged  
5 entity programs, uses only annual receipts. It does not  
6 use employee-based size sector at all.

7           For those industries that SBA determines are  
8 more properly measured by an employee-based standard,  
9 however, I believe the SBA should count the number of  
10 employees based on a full-time-equivalent status, rather  
11 than continuing the current standard which counts each  
12 individual whether he or she is employed on a full-time,  
13 part-time or temporary basis.

14           One of the keys to success for many women  
15 entrepreneurs is flexibility in employment. Such policy  
16 should be encouraged not discouraged by the SBA. A rule  
17 which counts every employee as a full-time employee,  
18 even though he or she may be working part-time or in a  
19 job-sharing arrangement, discourages small businesses  
20 from offering flexible working arrangements.



21           It also results in small businesses that offer  
22 flex-time or part-time options to its employees, being  
23 at a competitive disadvantage to those businesses that  
24 do not offer such arrangements.

25           with regard to the issue of verification of  
1 information on a part-time basis, I don't believe it's <sup>20</sup>  
2 an insurmountable hurdle. Small businesses only need be  
3 reminded that any misrepresentation to the SBA of the  
4 number of employees employed by the business would  
5 constitute a false claim or a false statement, subject  
6 to civil and criminal penalties.

7           In my remaining minute, I'd like to emphasize  
8 three points. First, there is a legitimate concern that  
9 any major change in the small business size regulation  
10 could result in tens of thousands of businesses losing  
11 their small business eligibility for federal government  
12 programs.

13           I believe that the SBA, if it adopts any  
14 significant change in its rule, should either  
15 grandfather in existing small businesses or establish a  
16 transition period for those businesses that no longer  
17 qualify as small under the new regulations.

18           Fourth, SBA's consideration of a micro  
19 business size standard is, I believe, is a step in the  
20 right direction, and we would be in favor of that.

21           Fifth, joint ventures. SBA should continue to  
22 promote joint ventures between small business  
23 contractors, especially in this environment of contract  
24 bundling and significant hurdles to federal government  
25 contracting.

SanFrancisco.txt

1 Finally, the SBA in considering its new rules  
2 should address the issue of a change in size during  
3 contract performance. And the SBA should promulgate  
4 additional rules concerning situations where a small  
5 business reaches and exceeds its size standard prior to  
6 the expiration of, for example, a schedule contract or  
7 where a small business with one or more scheduled  
8 contracts is purchased or acquired by a large business.

9 Thank you.

10 MR. KLEIN: Thank you. On that last point, what  
11 would you recommend?

12 MS. MEAGHER: Well, it's a difficult question. My  
13 concern is that small businesses that have scheduled  
14 contracts, if they become large during the course of the  
15 scheduled contract or are acquired because of the  
16 scheduled contract, depending on the term that is left  
17 in the schedule, you could, for example, prohibit the  
18 contractor from accepting any new orders under the  
19 scheduled contract, although allowing that contractor to  
20 continue to work out or perform the orders that have  
21 been placed. There would also be --

22 MR. KLEIN: SBA has a proposal out there on the  
23 issue of schedules and what will award contracts  
24 generally.

25           We propose that firms must be certified  
1 yearly. Where that ends up, we can't say at this point<sup>22</sup>  
2 in time. But that applied only to scheduled and  
3 multiple work contracts. Would you think it should only  
4 apply to that situation, or should it apply to all small  
5 business contracts generally?

6 MS. MEAGHER: I think it should apply to all

7 multi-year contracts. But if the contract is not a  
8 multi-year contract, then it should not apply.

9 But those contracts that have a one-year base  
10 and four one-year options, for example, you may want to  
11 look at that. Because there are small businesses that  
12 are acquired solely because of the fact that they have  
13 this contract.

14 MR. KLEIN: On another point, you said that you  
15 found reducing the number -- well, you found currently  
16 it to be not confusing, and the number should not be  
17 reduced just to be reduced.

18 we have heard other people speak to say that  
19 some industries that are related industries have  
20 different standards, and sometimes contracting officers  
21 will pick one versus another, to try to get certain  
22 firms eligible versus other firms.

23 Do you think we should look to make related  
24 industries the same size standard, or how would we  
25 counteract the contracting officer's tendency, at times,

1 to pick certain codes to get firms eligible or not? 23

2 MS. MEAGHER: I don't think the way to address that  
3 is to change the number of size standards. The way to  
4 address that would be to train the SBA officers, train  
5 the contracting officers out in the procuring agency,  
6 have SBA have some oversight as to what the contracting  
7 officer may be doing in determining the applicable size  
8 standards, and also have a process for appealing that  
9 others -- or protesting, but appealing the contracting  
10 officer's determination if it is less than reasonable.

11 MR. KLEIN: Finally, my last question was, you said  
12 that you were in favor of some kind of micro size

13 standard.

14 MS. MEAGHER: Yes.

15 MR. KLEIN: What exactly would that be for?

16 MS. MEAGHER: It would be for emerging businesses.

17 MR. KLEIN: Would there be a new set aside? What's  
18 the point of having that?

19 MS. MEAGHER: My preference would be that a micro  
20 business program would be in addition to the small  
21 business program.

22 I don't know what the realities are in  
23 Washington for that to happen, but there is a legitimate  
24 concern that the smallest of the small are not -- it's  
25 hard enough for small businesses to get federal

1 government contracts. It's more difficult for the  
2 emerging businesses.

3 And I think out here in California where we  
4 have a lot of emerging businesses down in the Silicon  
5 Valley that want to participate in federal government  
6 contracting, that they be given the opportunity to do so  
7 and to do it on a very -- you know, a mini business, a  
8 micro-business level.

9 MR. JACKSON: Just a follow-up question. I'm  
10 interested in what you would consider a micro business  
11 or an emerging small business.

12 There is a program called the Small Businesses  
13 Competitiveness Use Demonstration Program that applies  
14 to the four industry category. It defines an emerging  
15 small business as one-half the existing small business  
16 size standard.

17 would that be a viable definition, in your  
18 view, or do you have a different level that you would

24

SanFrancisco.txt  
19 view a micro business?

20 MS. MEAGHER: I believe the micro business size  
21 standard should be determined by the experts that know  
22 the particular sector. And, Mr. Jackson, you're among  
23 them, so I will defer that to you.

24 MR. JACKSON: Maybe I shouldn't have asked.

25 MR. KLEIN: Thank you.

1 The next person is Isabel De La Torre? John 25  
2 Robbins?

3 MR. ROBBINS: Good morning. My name is John  
4 Robbins. I am CEO of a small commercial real estate  
5 services company called Carpenter/Robbins Commercial  
6 Real Estate headquartered here in Northern California.  
7 We have 12 employees, and we are a service-disabled  
8 veteran-owned small business.

9 We have been following this issue of size  
10 standard for some time now, and unlike previous  
11 presenters, we see some advantages to the issue of  
12 employee versus revenue in deciding on size.

13 The present system makes no allowance for  
14 geographic differences in industries, and specifically  
15 the real estate industry. Cost of doing business  
16 differs substantially from region to region. Revenues  
17 differ substantially between high cost to do business,  
18 also using high revenue versus low-revenue areas,  
19 especially California, for instance, where the median  
20 income, according to the National Association of  
21 Realtors, was about \$65,300 for a real estate broker in  
22 the United States. That's a gross revenue number.

23 Typically, that means that they are going to  
24 be resulting in about 22.9 people in a firm, if you

25 consider a small business before it meets the standard

26

1 for our particular NAICS code. That translates to  
2 roughly generating revenues for business operation of  
3 about \$19,650 per person. And that's about what it  
4 costs to run a business.

5 So at the small business standard, you'd be  
6 breaking even if not making any money according to the  
7 present code utilized for our industry.

8 It appears to me that a -- at least for our  
9 service-based industry, and I would make the comparison  
10 of one the previous speakers made, that the salon  
11 industry is a \$6 million standard. Our industry is a  
12 \$1.5 million standard. There seems to be substantial  
13 inconsistency in the application of the revenue model,  
14 at least in regards to our industry.

15 So in summary of that, basically we feel that  
16 a move to a more employee-based system would serve our  
17 industry, we think, in a better way.

18 That's my comments. Questions?

19 MR. JACKSON: Just for clarification in how we  
20 calculate the size standards in the salon industry and  
21 most service industries, is on a gross receipts basis.

22 For real estate agents and other agent-like  
23 activities, we do exclude certain revenues. So we're  
24 looking at more of a net concept. Still relatively low,  
25 but --

27

1 MR. ROBBINS: Well, you exclude net revenues to  
2 other brokerage companies, but not to the individual  
3 broker, gross revenue to the broker.

4 Also, in our industry, the revenue splits are  
5 substantially high, so the net income to the individual

6 on a \$65,000 revenue, he or she probably takes home  
7 anywhere from 80 to as high as 90 percent of that in  
8 some cases.

9           So the net result is that while it appears to  
10 be a little more equitable, it still leaves us with an  
11 extraordinarily low number in terms of our industry.

12       MR. JACKSON: You indicated that you would prefer  
13 number of employees for your industry.

14       MR. ROBBINS: For us it would eliminate the issue  
15 of gross revenue.

16           In California, per salesperson might be  
17 300,000, \$400,000, which would put -- two people would  
18 basically eliminate you -- three people would eliminate  
19 you from small business. A hundred thousand dollars, 15  
20 people would eliminate you from being a small business.  
21 That same number in Ohio might be 50 people before it  
22 would eliminate you from being a small business. So  
23 there is a substantial difference.

24           By the way, we are a contractor with the  
25 federal government at this point, so we are very

1 familiar with the process and what it goes through to do<sup>28</sup>  
2 that.

3       MR. JACKSON: We've heard testimony earlier this  
4 morning and at other hearings concerning that if we use  
5 a number of employees for a service-type or  
6 labor-intensive activity, that it's burdensome on the  
7 businesses.

8           How do you view that issue? Do you think  
9 that's more of a burden in calculating size?

10       MR. ROBBINS: I think it depends on how you request  
11 the information to be delivered.

12               Certainly, if you have to deliver, you know,  
13 records of information, it would be, as most small  
14 businesses today are self-certified, in terms of size  
15 standards, as I understand it.

16               I know that the disabled veteran businesses  
17 are all self-certified to the federal government. It's  
18 only if they are called into question that they have to  
19 produce records.

20           MR. JACKSON: Thank you.

21           MR. KLEIN: James Hooper? Just for clarification,  
22 can you please spell your business's name as well, so  
23 the court reporter can get it right? Thank you.

24           MR. HOOPER: My name is James Hooper, J-a-m-e-s,  
25 H-o-o-p-e-r, and the firm is Hooper's Contract

1 Management Services. And I wanted to thank everybody 29  
2 for giving me the opportunity to talk here today. I'm  
3 new in this area, from the SBA standpoint, because I  
4 signed up last year.

5               And I've had some difficulties trying to get  
6 government contracts, probably from my standpoint  
7 because I am truly a micro business. I am one person.

8               I believe you need to have some background on  
9 my past. I have worked in the electronics industry for  
10 the last 42 years, as a director of quality. I have  
11 worked for small companies that range anywhere from 20  
12 people up to somewhere around 20,000 people, when I  
13 worked for Advanced Micro Devices.

14               I retired a few years ago and became a  
15 consultant. When I became a consultant, I thought I  
16 could do some work in the government contracting  
17 department. I've had a little trouble there because I



18 don't always have the time to rummage through and find  
19 all the contracts, which makes it very difficult.

20           Based on the information I received about the  
21 hearing, the SBA was established to protect an interest  
22 in small business and to ensure that fair representative  
23 share of government contracts were placed with small  
24 businesses.

25           It is also my understanding that a small

30

1 business is one that is independently owned and  
2 operated. When I think of a small business, the size is  
3 a firm less than 20 people. That's the way I think of  
4 it. When I owned my delicatessen, I didn't have that  
5 many people.

6           Again, as I said, I worked for companies  
7 anywhere from 20 to 250, and also up to 18,000.

8           I am against the unfair competition that will  
9 be created by raising the size standard for small and  
10 greater than 500 employees. I really believe that to be  
11 fair the size for small business should be less than 250  
12 employees. Again, the grandfathering should be a  
13 consideration -- should not be a consideration for any  
14 firm. I think that grandfathering does not pertain to  
15 this area.

16           No exclusion should be allowed. Any company  
17 that has a major interest in any company whereby the  
18 smaller company meets the size standard established by  
19 the SBA for the government contract, the size of the  
20 contract of the combined company must be used, as far as  
21 I'm concerned, because you have a chance to use the  
22 larger firm to do some of the things the smaller firm  
23 would not be able to do.

24 I agree with the SBA's current affiliation  
25 regulations. I am against allowing exemptions for

31

1 franchises, which is unfair competition to an  
2 independent company. Nonmanufacturing sizes should be  
3 reduced to 100 employees, that include both full- and  
4 part-time. I heard other people that did not agree with  
5 that, but I believe that in today's marketplace the  
6 trend is towards more of the part-time employees, and  
7 you may have two part-time employees that do what one  
8 employee has been doing in the past. So it really does  
9 provide for an unfair competition to an individual.

10 Nonmanufacturing size should be returned --  
11 nonmanufacturing sizes should be to 100 employees, that  
12 include both full- and part-time employees.

13 Again, I'd like to thank you for giving me the  
14 opportunity to talk here today. I don't have a great  
15 deal to say because I don't have a lot of government  
16 contracts. I would like to get some. But I have not  
17 done that. And I'm affiliated with other independent  
18 contractors that I can hire from time to time. I do it  
19 as a subcontractor support.

20 MR. PACCIONE: Mr. Hooper, just a point of  
21 clarification, we do size determination when there are  
22 protests regarding the size standards of a company, and  
23 we certainly review the affiliation. That is a big  
24 deal.

25 So, in other words, for example, if someone is  
1 a wholly-owned subsidiary, you are quite correct in  
2 saying the larger entity can provide financial  
3 resources, contract assistance, so we do a lot of

32

4 checking on affiliations and ownership. That's a  
5 normal, regular routine.

6 MR. KLEIN: My only question was regarding  
7 grandfathering, what that meant in the Advance Notice  
8 was in the proposal we had last year, 2004, when we  
9 converted certain -- when we proposed to convert certain  
10 industries from revenues to employee-based standards,  
11 some small businesses became other than small merely by  
12 the crossover from revenues to employee-based.

13 SBA intended to make them, the same firms  
14 eligible that were eligible before, but unfortunately,  
15 some actually fell out in that crossover. So what the  
16 commenters were responding were saying, those businesses  
17 should, in fact, be grandfathered for a certain period  
18 of time. What do you feel about that issue?

19 MR. HOOPER: I really believe that once that  
20 crossover is made that the contracts that they have at  
21 the time they should complete, but no new contracts.

22 MR. KLEIN: So you think there should be no  
23 grandfathering immediately?

24 MR. HOOPER: Yes.

25 MR. KLEIN: Thank you.

33

1 Lee Kenna?

2 MR. KENNA: That's L-e-e, K-e-n-n-a. The company  
3 is S-I-M-C-O, SIMCO Electronics.

4 SIMCO Electronics is an employee-owned company  
5 founded in 1962, that provides instrument calibration  
6 repair services for test and measurement instrumentation  
7 under contract.

8 Since 1965, SIMCO has provided its services  
9 under different contracts to various mass facilities and

10 measurement laboratories, the United States Army, Air  
11 Force, Navy, as well as many corporations that  
12 manufacture products within North America.

13           we've qualified for many of these as small  
14 business under originally SIC codes, and later NAICS  
15 codes. Since the applicable standard is usually set by  
16 the contracting officer depending upon the goals of that  
17 particular procurement, the contracting officers have  
18 widely varied the SIC codes or NAICS codes that we've  
19 been applicable under.

20           In some cases we have been providing services  
21 under one small business code, when another contract we  
22 had was recomputed with a different SIC code than we  
23 were just performing under. So we lost one, or we kept  
24 another one. Are we still qualified?

25           The latitude under which you look at a

34

1 technical service company, given the contracting  
2 officer, is whatever he wants to call it. And as a  
3 subcontractor, which we are today, we are a hundred  
4 percent subcontracted.

5           The applicable small business standard that  
6 prime can use is totally in the wind. They do not have  
7 any clear guidance as to whether their NAICS codes  
8 applies to all subcontractors, or in our case, a  
9 technical service contractor, where we can be support  
10 for R&D, we can be a repair center, we can be a  
11 calibration center.

12           The size standards for all those are  
13 different. And under support for R&D, which is  
14 generally what we do, the size standard today is a  
15 thousand employees and in the others it's 5 million or

16 \$15 million in sales.

17           These contracts are used for different  
18 purposes as well. When we were a NASA contractor at  
19 Johnson Space Center, maintaining a laboratory of 50  
20 people, at that time government contracting was half of  
21 our work. When we were a contractor at NASA Ames  
22 Research Center, that one contract was half of our work.

23           If we lost that contract, we were basically  
24 out of business. And the applicability of sales  
25 standards was one of those things that could have put us

1 out of the government contracting; in or out. 35

2           And so my suggestion is that you focus in  
3 technical service contracting not on gross receipts. So  
4 whether we buy instrumentation of a million dollars  
5 under a \$2 million contract doesn't matter because we  
6 don't buy it for ourselves; we buy it because the  
7 government asks us to put it in their contract.

8           Gross receipts standards swing widely, and  
9 actually has been used, as I mentioned, to give us  
10 qualification under one, out of qualification under  
11 another, when it's an important part of our business.

12           I'd also like to emphasize that recent -- and  
13 I was just given this information by the inspector  
14 general for the SBA, indicated that the number of small  
15 business contracts going to larger businesses.

16           I do think it's important that we stop that  
17 practice, that we not let large businesses acquire small  
18 business and keep the contract, and that, in effect, an  
19 acquisition could be considered a new qualification.

20           I've seen that happen. I've also seen large  
21 businesses ask certain of their employees, because they

22 have a small business size requirement, to go out and  
23 set up a new company. We'll give you this business as a  
24 subcontractor, but we have to have a small business to  
25 do this under. And that's, in my opinion, a shell

1 corporation; which is, again, directly related to the  
2 affiliation issue. I know it's hard to get to.

36

3           So my suggestion is that for service  
4 industries that we look at a common standard of 500  
5 full-time-equivalent employees in the previous three  
6 years, and that related industries should have the same  
7 size standard.

8           I think it's very important that we eliminate  
9 this ambiguity. More importantly that we provide clear  
10 guidance to contracting offices, which is few standards,  
11 so that they won't have to decide which of 15 might  
12 apply in this case, or if you have a prime, that he  
13 doesn't have to question whether his subs qualify or  
14 not. And I've seen an awful lot of cases where people  
15 certify to a size standard and then what they really do  
16 is spin off three people who keep that.

17           I think the idea of venture capital companies  
18 being able to invest for consortium venture capital  
19 companies who own billions of dollars worth of assets  
20 create a small business to compete for government  
21 contracting is a really a poor idea, and similarly this  
22 affiliation thing should be squeezed as much as we can.

23           My main suggestion is that you keep the  
24 administrative costs low in procurement and eliminate  
25 loopholes for large business, which I think is part of

1 the large business company's gain in manipulating the  
2 system. We should eliminate it.

37

3 Questions?

4 MR. KLEIN: Regarding venture capitalists, are you  
5 referring to the SBIR industry, or just in general?

6 MR. KENNA: If a company that doesn't meet the size  
7 standards invests in or buys 51 percent, or if a  
8 consortium of large businesses which collectively owns  
9 smaller -- collectively own 51 percent of small  
10 businesses, then I think that should be up for review;  
11 and even for the next modification of the contract.

12 My other comments are in that written  
13 statement. I know you all are --

14 MR. KLEIN: I have a question or two.

15 MR. KENNA: Yes.

16 MR. KLEIN: You mentioned the IG report. And,  
17 basically, what that said was that some firms who had  
18 received contracts as small businesses had grown too  
19 large or had been acquired and those contracts continued  
20 to be counted as small business contracts.

21 MR. KENNA: I can see a problem with being acquired  
22 and letting the acquiring company continue to perform  
23 after that.

24 MR. KLEIN: Right. I'm wondering if you are aware  
25 of the rule we published recently which said that if

1 innovation is required, if they have an acquisition 38  
2 where the small business is merged into a large  
3 business, when innovation is required, you must certify  
4 again that innovation, so that in order to continue to  
5 count as a small business, you would have to be small at  
6 the time of innovation. That that rule just went into  
7 effect a few months ago. I was wondering if you had  
8 been aware of that.

9 MR. KENNA: I don't follow those rules. Our  
10 contracting officers are baffled by the rules. That's  
11 the problem. Part of it.

12 Thank you for the opportunity.

13 MR. JACKSON: One question. In your testimony you  
14 mentioned that contracting officers have way too much  
15 latitude in deciding what the size standard is.

16 SBA does have a protest process that on a  
17 decision by a contracting officer to designate a  
18 particular North American Industry Classification System  
19 for the contract and by default the SBA design standard  
20 for that particular industry category, challenges can be  
21 made.

22 We recognize that there have been varying  
23 interpretations. Part of that may be because of the  
24 description of the industry. Other times, other  
25 reasons, quote/unquote.

1 You mentioned in your testimony, related  
2 industries should have separate size or similar size  
3 standards. That's certainly one approach.

4 Should SBA look at the notion of using NAICS  
5 codes to identify what size standard applies to a  
6 contract, or are the NAICS codes workable, it's just  
7 that the standards need to be more similar?

8 MR. KENNA: I think a technical services company is  
9 essentially a technical services company. And right now  
10 there are probably eight different size standards and,  
11 they are differently chosen as the appropriate one for  
12 NAICS -- different NAICS codes chosen which had  
13 different size standards.

14 The two that I am referring to, and I don't

39



15 know the NAICS codes as they translated from SIC codes,  
16 but R&D support, broadly speaking, which was one under  
17 which we provided work for Johnson Space Center for  
18 about ten years, had a size standard of a thousand  
19 employees. Many of them have gotten back to 500. I  
20 find this absolutely appropriate.

21 But one contract can be 50 to a hundred people  
22 for us. You lose that contract, you're in or you're  
23 out. And so if you talk about 25 people, if you win one  
24 contract, you can no longer qualify, and that blows your  
25 business out of the water if its a small business.

1 But again, 500 people, I think is tolerable 40  
2 under the technical services standards. But if you put  
3 us at 15 or \$5 million in gross revenue, and somebody  
4 asks you to buy \$3 million worth of hardware under your  
5 contract, it's the kind of thing that doesn't apply in  
6 gross revenues.

7 Again, a \$3 million company or a  
8 thousand-dollar company may not be considered  
9 technically competent to do many of these jobs that  
10 others could do. And so we've seen them advertised as a  
11 small size standard primarily because they know they  
12 cannot get responsive, technically qualified people, and  
13 all of a sudden Lockheed and Boeing are competing  
14 against you.

15 So Lockheed and Boeing love that. If they  
16 have an in with the contracting officer, they will have  
17 it set at a size standard that they can't get anybody  
18 capable of responding.

19 Technically competent people need to have, in  
20 my opinion, more than a hundred employees. We are at

21 200 right now. 500 I think is a very workable standard.

22 The dollar figures, unless they are larger  
23 than anything I've seen, make it very difficult to  
24 manage.

25 MR. KLEIN: Thank you.

41

1 Kerry Lee?

2 MS. LEE: Good morning. Kerry Lee on behalf of the  
3 California Restaurant Association. My name is spelled  
4 K-e-r-r-y, last name L-e-e.

5 On behalf of the 81,000 food service  
6 establishments in the state, we'd like to comment  
7 regarding potential changes to small business size  
8 standards.

9 As California's largest employers, the  
10 restaurant industry is the cornerstone of the economy  
11 procuring employment opportunities and community  
12 involvement.

13 California restaurants provide work for almost  
14 70 percent of those employed in the state, and the  
15 restaurant industry generates more than 4 billion in  
16 sales tax revenues to the state each year.

17 Although the restaurant industry's role in  
18 stimulating the economy is extends to the average profit  
19 margin, the restaurant's is very small; approximately 3  
20 to 5 percent for independent businesses. For every  
21 dollar of sales it brings in, a restaurant keeps less  
22 than a nickel of profits.

23 As an industry that is comprised mainly of  
24 small independent businesses facing diminutive profit  
25 margins, the ability to take advantage of SBA programs

42

1 and other benefits under federal and state law is often  
2 crucial to their survival. Furthermore, given the fact  
3 that every dollar spent in restaurants generates more  
4 than \$2 in business, for other industries the ability of  
5 restaurants to keep their doors open is critical.

6           So in contemplating changes to small business  
7 size standards, it's important to consider the  
8 significant differences between the restaurant industry  
9 and other nonmanufacturing sectors with regard to  
10 structural economic characteristics.

11           The National Restaurant Association has  
12 provided SBA with detailed information on these  
13 characteristics, demonstrating that the restaurant  
14 industry is extremely labor intensive, employs a high  
15 proportion of part-time employees, and is highly  
16 seasonal. Therefore, any potential changes, including  
17 an employee-based size standard, would not be  
18 appropriate for the restaurant industries.

19           Given these differences and potential adverse  
20 impacts that sweeping changes might have on the  
21 restaurant industry, the California Restaurant  
22 Association would like to reiterate the concerns that  
23 have been raised by the National Restaurant Association  
24 with regards to simplification of size standards, the  
25 calculation of the number of employees, and the use of

1 receipts-based size standards.

43

2           To this end, we fully support the position of  
3 the National Restaurant Association with respect to  
4 that -- to small business size standards, and  
5 respectfully request that this be taken into  
6 consideration when changes to the standards are

7 considered in the future.

8           So we just echo the National Restaurant  
9 Association's position for the current standards for our  
10 industry.

11           No questions? Thank you.

12           MR. KLEIN: Dulce Morales? David Rhodes?

13           MR. SHUKLA: Good morning. My name is Deb, D-e-b,  
14 S-h-u-k-l-a. I'm president of a company called  
15 Innovative Technical Solutions, Inc.

16           This discussion actually could take place in a  
17 different context. From a federal procurement point of  
18 view, procurement tendencies are really such that the  
19 binding of contract, bigger and bigger contracts come in  
20 place. And small business size standards that we have  
21 today have to go up in order for a small business to be  
22 viable.

23           We have, for instance, a contract which is  
24 \$4 billion regional, national, worldwide. The small  
25 business size standard is \$28.5 million. Bonding

1 requirement is hundred-million dollars. Now, how do we<sup>44</sup>  
2 think that the \$4 billion contract for the small  
3 business size standard is \$28.5 million, the bonding of  
4 hundred-million dollars is going to compete? So a  
5 \$28.5 million contract is immediately competing against  
6 (inaudible.)

7           The idea of SBA or small business protection  
8 is to allow businesses to nurture themselves to full  
9 health. So having a size standard so small that as soon  
10 as you cross you are competing against big giants is  
11 inappropriate.

12           It is tantamount to having a five-year-old

13 person being declared as an adult. So at least have  
14 16-year-old person that take care of an adult. Don't  
15 have five-year-old person now all of a sudden drive to  
16 school or football field, or whatever.

17 So as procurement becomes bigger and bigger  
18 and bigger, the size standard has to be bigger rather  
19 than smaller. Whatever you guys do, don't have existing  
20 small businesses disqualified from the small business  
21 size standards.

22 In terms of revenue versus employee, the  
23 debate is very clear. I am in the business of  
24 environmental remediation and construction engineering.

25 Environmental remediation, I may have to dig  
1 up a site which had PCB-contaminated stuff which I have<sup>45</sup>  
2 to truck to someplace, some landfill, at a very high  
3 cost. And I have no control over how big a hole I have  
4 to dig. And this is just a pass-through cost. So why  
5 revenue-based size standard for us?

6 For all companies and businesses where there  
7 are a lot of pass-through costs, it should be  
8 employee-based size standard. I cannot manage by  
9 revenue. I cannot manage my company by revenue. I can  
10 manage by how many employees I have.

11 Now, there are -- I heard some good arguments,  
12 there are some other businesses where it might make  
13 sense to manage by revenues. But for business like  
14 ours, construction, environmental remediation, has to be  
15 employee based. That's the only way I can manage.

16 And I have to provide those reports to the  
17 government anyway. How many employees? How many hours?  
18 So providing that information may be slightly

19 burdensome, but hey, we are all used to IRS and fifty  
20 other organizations. We can provide it.

21 But the pass-through costs should not be  
22 counted against us. I propose a size standard for our  
23 business to be 500 employees, and perhaps consideration  
24 of another smaller micro size standard, which is 50  
25 employees.

46

1 Going back to the example of five-year-old  
2 being not an adult, I think a common sense way would be  
3 to have a size standard such that a small business can  
4 now truly look forward to getting out of being a small  
5 business and competing with the large business. So size  
6 standard should be large enough so that it starts  
7 competing against large businesses.

8 So, for instance, a very rational way would be  
9 you take five companies, the largest companies in your  
10 business, take their average number of employees, their  
11 revenues, and take one-tenth of that. That is a size  
12 standard.

13 If I am competing against Bechtel and if I am  
14 one-tenth of Bechtel, or -- Bechtel is probably too  
15 large. I could never be one-tenth of Bechtel. But  
16 let's say, if you took five large companies or ten large  
17 companies, and took the average of that and took  
18 one-tenth of that, that should be the size standard.

19 Because now I can be allowed to be in a  
20 protected water until I am 15 years old. And when I get  
21 out, I can have a good chance of being an adult by  
22 creating a real company.

23 Now, a lot of people here are thinking of size  
24 standards as for loans and so on. That should be a

25 different size standard. For procurement, it has to be

47

1 larger size standard, because bundling of contract is  
2 reality. Government is running out of contracting  
3 officers.

4 So you have to look at whatever you are doing,  
5 have it much larger, and establish another size standard  
6 for micro businesses.

7 So full-time equivalent is the way to count  
8 employees. That is -- just makes lots of sense. Lots  
9 of businesses do that.

10 And if you must go to both size standards, do  
11 not have -- I mean, you allow small business the  
12 flexibility to qualify, either on the basis of revenue  
13 or on the basis of employees. Let them qualify. Why  
14 are you restricting the growth of a small business?

15 The idea is to nurture small business so that  
16 they can get out of small business, not forever remain  
17 enslaved into being a small business. So some  
18 discussions, I tell you we will -- my time is up.

19 Some of the discussion is to protect the small  
20 businesses, but for them to remain forever a small  
21 business that's not what the national goal is. Small  
22 business should get out and become a full, regular  
23 business some day.

24 MR. JACKSON: You mentioned 50-employee size  
25 standard. Would you envision a separate set aside

48

1 program for that, or some other benefit.

2 MR. SHUKLA: Absolutely. Or have a size  
3 standard -- fifty or hundred, I don't care, but there  
4 should be 500-employee size standard to compete against  
5 Jacobs and Bechtel for some products. Not all products.

6 There should be 50, hundred-employee size standard to  
7 allow some really startup companies to nurture and  
8 become who they are.

9 MR. JACKSON: Followup, kind of the opposite side  
10 of the question.

11 If we're looking at the size of federal  
12 contracts and also the size of the major companies in an  
13 industry to set the size standard, aren't we really  
14 looking too much at large-size and mid-size businesses,  
15 instead of focusing on smaller businesses that tend to  
16 have disadvantages because of their size? Aren't we  
17 losing sight of who is really small within the industry?

18 MR. SHUKLA: Not really. The whole purpose of  
19 providing such a society is to provide a protected water  
20 for the fish to grow to enough size or for us to grow to  
21 be fending for ourselves.

22 So how do you do that? I mean, if you  
23 don't -- if you don't have that transition point, these  
24 companies will forever be slave to remain -- first to  
25 remain small business, or go out of business.

1 As a nation we want to grow the economy and  
2 the employment. You want to allow these businesses to  
3 really grow and become a regular business some day, and  
4 be out of the small business assistance.

5 If you drop them as a five-year-old, then they  
6 cannot drive to school, they cannot drive to playing  
7 field. You have to allow them to be 15, 16 before,  
8 okay, you are on your own.

9 MR. KLEIN: Thank you.

10 Sharon Gadberry? Suzanne Tucker? Jose Zero?  
11 Barbara Felt? August Moretti?



12 MR. MORETTI: Good morning. I'm August J. Moretti,  
13 the chief financial officer of Alexza Molecular Delivery  
14 Corporation. I would like to thank the SBA for allowing  
15 me to give testimony this morning.

16 I'm here to address the issue of venture  
17 capital firms and ownership requirements of the  
18 definition of small business for SBIR grants.

19 My points today are, one, emerging life  
20 science companies are an important segment of the U.S.  
21 economy.

22 Two, emerging life science companies today  
23 need to raise significant amounts of funding to be  
24 successful, in light of a long time required to develop  
25 and obtain regulatory approval for our products.

1 Three, most successful emerging life science <sup>50</sup>  
2 companies have to resort to venture capital financing in  
3 order to secure necessary funding.

4 Four, SBIR grant funding is an important  
5 source of support for today's emerging life science  
6 company.

7 And, five, it would be counterproductive to  
8 disqualify those companies that have received venture  
9 capital financing from SBIR funding. This would hurt  
10 the SBIR program because it would eliminate some of the  
11 very best small businesses from providing  
12 government-sponsored research, and it would hurt the  
13 life science industry by depriving some of the very best  
14 emerging life science companies of government support  
15 for their research.

16 By way of background, Alexza is a Palo  
17 Alto-based specialty pharmaceutical company founded in

18 December 2000. We have developed unique pulmonary  
19 delivery technology for the rapid noninvasive  
20 administration of therapeutics, and we currently employ  
21 95 people, most of whom are scientists and engineers.

22 We have one drug compound in clinical trials.  
23 We expect to have another in clinical trials in July,  
24 and two more by the end of the year.

25 Alexza was founded by Alex Zaffaroni, and

1 Dr. Zaffaroni and his family funded the company during<sup>51</sup>  
2 the early years of its existence. As a result, he  
3 qualified as 51 percent owned by individuals.

4 It's worth noting that Dr. Zaffaroni has  
5 founded a number of Bay Area companies, including ALZA,  
6 which was recently acquired by Johnson & Johnson,  
7 Affymax, Affymetrix, Maxigen and others.

8 These companies, in the aggregate, have  
9 produced thousands of high-paying jobs in the Bay Area,  
10 and significantly many of these companies were  
11 recipients of federal grant money during the early  
12 stages of their development.

13 This grant money was very important in  
14 supporting early development efforts and, indeed,  
15 Affymetrix developed this revolutionary GeneChip  
16 technology with the substantial help of the MIST grant,  
17 which I believe was the largest of its kind at the time  
18 it was granted.

19 Maxigen received substantial amounts of grant  
20 funding for various research projects, including  
21 projects related to vaccines and bioterrorism.

22 Each of these companies has raised many  
23 millions of dollars in funding, in addition to the

24 government grant money, in order to support operations  
25 and continue development of their products.

52

1           Alexza has been fortunate to have received  
2 SBIR funding on each separate grant, for a total from  
3 inception of an aggregate of approximately \$5 million of  
4 grant revenue. We've used the funds to support research  
5 on the application of our delivery technology to  
6 therapeutic areas of significant medical interest.  
7 These funds were very helpful in supporting our  
8 operations and developing our technology in our early  
9 years.

10           However, although the grant funds were  
11 extremely helpful, they were insufficient for our needs.  
12 Indeed, at Alexza, we have raised over a hundred-million  
13 dollars of equity capital in four separate rounds of  
14 private financing. We could not have satisfied our  
15 funding needs without resources of the venture capital  
16 community.

17           Although we continue to have a number of  
18 individual stockholders after four rounds of financing,  
19 an aggregate of more than 51 percent of our outstanding  
20 capital stock is owned by over 10 venture capital funds.

21           As a result of the rules passed by the SBA in  
22 December, requiring that an SBIR award recipient must be  
23 at least 51 percent owned and controlled by one or more  
24 individuals who are U.S. citizens, we are no longer  
25 eligible for SBIR funding.

53

1           we believe this is an unfortunate result for  
2 the SBIR program, for Alexsa, for similarly situated  
3 life science companies in the United States, and for the

4 economy and technological development in the United  
5 States.

6           We believe that the SBA should provide an  
7 exception to the 51 percent rule, to include venture  
8 capital firms in the definition of individuals.

9           Let me make a general statement about life  
10 science companies. Life science companies in the United  
11 States today are innovators in the development of  
12 life-saving technology, and have been responsible for  
13 the development of numerous breakthrough therapeutic and  
14 diagnostic products and medical devices in the field,  
15 such as cancer, cardiovascular disease, and central  
16 nervous system disorders.

17           In addition, we have created a substantial  
18 number of high-paying skilled jobs throughout the United  
19 States, jobs that are unlikely to be off-shored anytime  
20 soon.

21           These companies require huge amounts of  
22 funding. And just by way of example, local Bay Area  
23 companies -- to give you a sense of the need for venture  
24 capital financing, Geneoport of Palo Alto, a  
25 hundred-and-fifty-million dollars of private financing.

54

1 Sunesis (phonetic) Pharmaceuticals of South San  
2 Francisco, 105 million of private financing. Intarsia  
3 Therapeutics of Emeryville, 140 million in private  
4 advancing. Theravance of South San Francisco,  
5 430 million of private financing. Granovis of South San  
6 Francisco, 140 million of private financing. I could go  
7 on and on. And these companies are located in many  
8 areas around the United States, and are having a  
9 dramatic impact on the U.S. economy.

10 Thank you.

11 MR. JACKSON: Just a couple of questions.

12 I would like to clarify that the change in the  
13 interpretation was not really a change. It's always  
14 been our position that a company eligible for the SBIR  
15 program was required to be owned by 51 percent  
16 individuals.

17 I think there had been some oversight of that  
18 in certain cases, but the SBA has consistently  
19 maintained that interpretation of our current  
20 regulations.

21 MR. MORETTI: For the record, in my testimony I  
22 have cited an SBA Web site where it's -- if that were  
23 the rule, the recipients reflected on the Web site  
24 reflecting grants from '93 to '98, almost half of them,  
25 in my own knowledge, fail the test.

55

1 MR. JACKSON: Do you have those listed?

2 MR. MORETTI: I do. The cite to the Web site is  
3 there. I know the companies. I know a range of them.  
4 I know how much venture capital financing they had.

5 There were a number of companies who were  
6 public companies who never certified that they were  
7 51 percent owned by individuals because their stock is  
8 predominantly held in street name.

9 MR. JACKSON: We've also made a change, as a  
10 follow-up on that, where a publicly-owned company could  
11 qualify if it showed the stockholders were U.S.  
12 citizens. That's a very difficult thing to do, we  
13 recognize, but our recent change last December also  
14 addressed that.

15 MR. MORETTI: How could I, as the chief financial

16 officer of a company, certify that my stockholders were  
17 American citizens when the stock is held in street name?

18 MR. JACKSON: That's an excellent question. In  
19 fact, we're looking into that more so as these  
20 situations arise.

21 Let me get to my question. When you have a  
22 venture capital or group of venture capital companies  
23 having more than 51 percent ownership in a company, how  
24 does that affect your ability to control the operations?  
25 Don't the VCs then have the ability to direct the

1 activities of that company?

56

2 MR. MORETTI: Corporate governance in these  
3 transactions for private companies is very complicated  
4 in the sense that, typically, the board of directors  
5 is -- there's an agreement that would control the  
6 composition of the board of directors, would specify a  
7 number of directors for the venture capitalists.

8 But, for instance, if you look at our board,  
9 Dr. Zaffaroni and his son are both on the board. Our  
10 CEO is on the board.

11 We don't believe when we go into our board  
12 meetings that the VCs have the ability to tell us to  
13 change direction. It is a consensual discussion at the  
14 board level. And the board collectively has the  
15 responsibility for moving forward the business.

16 But we don't feel like we are controlled by a  
17 collective of venture capital firms.

18 MR. PACCIONE: Could I follow up? I just wanted to  
19 follow up on the question. We're in the business out  
20 here in the field of doing, actually, size  
21 determinations. We're familiar, of course, with the

22 51 percent rule on SBIR contracts.

23 I wanted to just ask you, do you believe that  
24 SBA should basically relax, let's say, the affiliation  
25 rule, when it comes to the venture capitalists? where

1 I'm going with this is, I'm really asking, some of the 57  
2 venture capitalists, when you start to look at the  
3 organizational structure of the corporation, in some  
4 cases you might have, for example, a venture capitalist  
5 that might be owned, say, 100 percent by Pfizer, then  
6 the venture capitalists, so we're always focused on the  
7 affiliation, the power to control the corporation.

8 Now, I recognize what you're saying, as well,  
9 in practical day-to-day operation we don't see it. But  
10 the question is, do you think we should make some  
11 exceptions considering SBIR research development, try  
12 to, you know --

13 MR. MORETTI: Partial response to that is there are  
14 a limited number of pharmaceutical company-controlled  
15 venture capital firms. So SR1 is SmithKlein. Eli Lilly  
16 has a venture group. And a rule that addressed those  
17 differently is something that might be worth  
18 considering.

19 The vast range of venture capital firms that  
20 companies like ours deal with are just -- are  
21 traditional venture capital partnerships, where the  
22 limited partners -- again, and this is why what's been  
23 proposed as a rule doesn't help, where the limited  
24 partners are Harvard, Stanford, Yale, Princeton,  
25 Teamsters pension plan, and so forth, large pools of

1 capital that are allocating small amounts of capital for 58  
2 alternative investment. But they are institutional

3 investors, by and large. They are not individuals.

4 MR. PACCIONE: When they put the money up, do  
5 they -- for example, whether it's the Teamsters or  
6 whatever entity, do you find that they own 20 percent of  
7 your corporation or another SBIR?

8 I'm trying to get at the percentage when the  
9 money comes in. See, because that's what we look at to  
10 see if the owners own 1 percent, 2 percent, you know,  
11 and then the venture capitalists, whoever they are, as a  
12 result of giving money, they want a percent of the  
13 ownership. We start to say, who owns the corporation?

14 MR. MORETTI: Right. But in our case, there is a  
15 group of 10 venture capital firms that own approximately  
16 57 percent of the company. That's ten firms. And so as  
17 I said, we don't believe when we go to our board  
18 meetings, we don't believe that there's a unified force  
19 that is directing the company. There's quite a bit of  
20 dispersion from the venture capital representatives that  
21 are on our board.

22 MR. KLEIN: We've heard throughout these hearings,  
23 as well, some individuals saying that if you're to the  
24 point where venture capitalists are owning more than  
25 50 percent, you're really beyond the SBIR. SBIR should

1 be more for the smaller firms. How can you respond to <sup>59</sup>  
2 that?

3 MR. MORETTI: In our industry, it's impossible to  
4 become a successful company without resorting to capital  
5 of the sort represented by the venture capital industry.

6 So if the program is designed to have the best  
7 people focusing on the research that the government  
8 would like to support, I think it's very



9 counterproductive to say that you're not going to  
10 take -- you're not going to allow folks who are venture  
11 capital financed to perform that research on behalf of  
12 the government.

13 MR. KLEIN: Thank you.

14 MR. MORETTI: Thank you.

15 MR. KLEIN: Waymon Olivier?

16 MR. OLIVIER: Good morning, gentlemen. My name is  
17 Waymon Olivier, and I'm the principal of Oliv &  
18 Associates, a graphic design and printing firm  
19 specialist. I'm certified SVB, and I'm a certified HUB  
20 Zone organization.

21 The vast small levels of government  
22 contracting opportunities at the federal, state and  
23 local levels, together with the model of focusing on  
24 subcontracts to major companies and government agencies  
25 have left the black American community without the

1 economic anchors to help support its self-determination. <sup>60</sup>

2 The continuing gap and long-standing variance  
3 between the black unemployment rate and the general  
4 unemployment rate is mostly due to the fact that black  
5 businesses have failed to make nearly as much progress  
6 in the mainstream of American business.

7 The federal government needs to continue  
8 increasing the number and scale of black-owned small  
9 businesses. Leadership by example.

10 The fate of black business owners in the  
11 United States is a leading indicator for the future of  
12 black American communities.

13 Governors, county executives and mayors  
14 understand that people who are not working because of

15 government's enormous amount of public funds for  
16 healthcare, education, criminal justice and housing,  
17 while reducing the base funds available to their  
18 jurisdictions, either directly or indirectly.

19           The success of many black-owned companies and  
20 freestanding businesses is a graphic demonstration that  
21 a higher level of business activity is called for today.

22           Finally, I have a few questions for you to  
23 answer, to the best of your ability. What group of  
24 businesses in the United States today pay a higher  
25 percentage of their overall U.S. tax burden in cities,

1 counties and states from the quantity of their overall <sup>61</sup>  
2 numbers?

3           Number two, what is the fastest-growing  
4 business segment in the United States economy today,  
5 which is starting more businesses and hiring more people  
6 as their companies expand its operations?

7           Number three, corporations are not located in  
8 every community in the United States. What business  
9 segment in the U.S. economy supports the maintaining and  
10 development of neighborhoods, communities and small  
11 cities, et cetera?

12           Number four, our troops are starting to return  
13 home from the war. In what type of businesses are these  
14 soldiers most likely to find employment?

15           Number five, why did the U.S. government find  
16 a need to create the business size regulation in the  
17 first place? Has their original reasons been improved  
18 on, eliminated, or have the goals been achieved?

19           Number six, the U.S. corporations are very  
20 profitable in the current U.S. economy. Why does

21 Congress need to give corporations more affirmative  
22 action by changing the business size regulation?  
23 Don't Congress understand that they will be  
24 taking opportunity out of the mouths of small businesses  
25 who are not asking for a handout, but for a helping

62

1 hand?

2 Number seven, is the changing of the business  
3 size regulations the greater good theory, sacrificing  
4 the many small businesses for the greedy few  
5 corporations?

6 what are the first three words in the U.S.  
7 Constitution? "We the people" or "We the corporations"?

8 Number eight, do we work for our  
9 representatives, or do our representatives work for us?

10 Number nine, and my final question, will the  
11 U.S. Congress stand up for something and not continue to  
12 fall for anything, or will they continue to go alone  
13 just to get along?

14 Thank you very much.

15 MR. KLEIN: Do you have any specific  
16 recommendations in that?

17 MR. OLIVIER: Well, you know, all I got to say  
18 about this is, this is a few tidbits that you can think  
19 about.

20 I mean, the SBA is here to help people. I've  
21 been certified since 2001 as a SVB in a HUB Zone, and I  
22 have no opportunity whatsoever. I've been getting work  
23 from southerners in Texas, and I was born and raised  
24 here in San Francisco. And this is not a democrat or  
25 republican issue. This is a human issue.

63

1 And I've been a registered Lincoln republican  
2 since I was 18 years old. I'm from San Francisco. But  
3 I got work from southern democrats, and I was born and  
4 raised in San Francisco.

5 I just wanted to say this. I need you to  
6 think about everybody, because we are a part of it. And  
7 you're supposed to be part of the solution, not the  
8 problem.

9 And, I mean, you're giving opportunity to  
10 people who got everything. And all we doing is asking  
11 for a helping hand. That's all we asking for.

12 MR. KLEIN: Okay.

13 MR. OLIVIER: Thank you.

14 MR. KLEIN: Paul Sabharwal?

15 MR. SWEATT: My name is Glenn Sweatt. Actually,  
16 I'm speaking on behalf of Paul Sabharwal for  
17 Environmental Chemical Corporation.

18 By way of background, we are a former 8(a)  
19 contractor. Graduated out of the program about seven  
20 years ago, and have been working in the small business  
21 arena since then.

22 We work primarily under NAICS Code 662910,  
23 which is environmental services, and we do primarily  
24 most of our work as a federal government contractor. My  
25 comments should be taken in that context.

1 I'm not speaking with regards to loan programs<sup>64</sup>  
2 or with regards to any other industries in the comments  
3 I am about to make with regards to the proposed rules.

4 There are two basic points that I want to  
5 make. The first is on the proposed rules being  
6 employee-based size standards.

7                   we've been operating under the NAICS under a  
8 500 employee-base size standard for the last ten years,  
9 so the proposed change certainly doesn't present any  
10 problems to us as an administrative burden to track  
11 those numbers.

12                   we do feel, however, that perhaps an increase  
13 to that size standard is warranted, based on the  
14 development of the industry over the last ten years and  
15 a re-evaluation of all industries.

16           MR. KLEIN: I'm sorry, what industry was that,  
17 again?

18           MR. SWEATT: Environment services. NAICS code  
19 562910. Basically, you've got three trends that have  
20 happened over the last 10 years. Large businesses have  
21 gotten larger; which makes it more difficult for small  
22 businesses such as ourselves to continue to compete.

23                   So a size standard that made sense 10 years  
24 ago, an employee size standard that may have allowed us  
25 to be a viable company, is not necessarily the same size

1 standard today that would allow you to continue to be a <sup>65</sup>  
2 viable company.

3                   when I first started 14, 15 years ago,  
4 probably three or four of the top ten companies have now  
5 all bought each other, creating mega companies that make  
6 it very difficult to compete.

7                   The second point that ties into that is, as  
8 somebody else referred to earlier, continued bundling of  
9 services within this industry, fewer contracting  
10 officers and fewer procurement lead to larger  
11 procurements with bundling services. So even with a 500  
12 employee-base size standard, it becomes difficult to

13 compete.

14           The third and final point that I want to make  
15 in this first area is that with the environmental  
16 remediation services industry, a majority of the work  
17 due to the variables in environmental work is cost-type  
18 work.

19           Cost-type contracting is maybe anomalous to  
20 the rest of government contracting in general, but it  
21 does require a significant number of additional systems,  
22 that any given day there are a plethora of auditors in  
23 our offices, and we have to have constantly review  
24 billing systems; estimating systems, accounting systems,  
25 government property management systems, procurement

66

1 systems, and you name it. The overhead and the  
2 individuals alone that are required just to maintain  
3 those systems, again, militates towards a higher  
4 employee-based standard.

5           So that really brings to a close my three  
6 points on an increase in the employee-based size  
7 standard for this particular NAICS code.

8           The second and the final area that I wanted to  
9 talk about today was the area of an exemption for  
10 overseas work, particularly the battlefield exemption  
11 for the work in Iraq and Afghanistan.

12           If you look at the business model that most of  
13 the employees that do work in these countries is  
14 directly at odds with the business model for an  
15 employee-based size standard, leaving small businesses  
16 such as ourselves with the choice between pursuing that  
17 work and vastly and rapidly exceeding your size  
18 standard, or not to pursue that work and not compete in

19 that market at all.

20           An example of this is very simple. The work  
21 that we're doing right now in Iraq and for a similar  
22 construction type of work that you do here in the  
23 states, you can do a typical project with perhaps 40  
24 people and a large amount of heavy equipment, mechanized  
25 means and efficient processes.

1           Due to the work in Iraq, the way that it must<sup>67</sup>  
2 be done in order to keep the maximum number of local  
3 Iraqis employed, you've got a direct opposition to  
4 keeping your head count low and at the same time being  
5 able to compete in that work.

6           This really leads back to the very large  
7 market wide open only for large businesses, and excludes  
8 small businesses from there.

9           For that reason, we would militate and suggest  
10 that an exclusion for Iraq and Afghanistan employees be  
11 factored into the new rules going forward as well.

12         MR. KLEIN: Thank you.

13           Dulce Morales? Subrizi? Lloyd Chapman?

14         MR. CHAPMAN: My name is Lloyd Chapman, L-l-o-y-d,  
15 C-h-a-p-m-a-n. I'm the president and founder of the  
16 American Small Business League.

17           We're here today to talk about size standards  
18 and changes in size standards. And I think before we  
19 look at changes, let's look at the current size  
20 standards and how they are working.

21           I'd like to start my testimony by reading a  
22 quote from a recent investigation by the SBA's own  
23 Office of Inspector General. Report No. 515 states:

24           One of the most important challenges facing

25 the Small Business Administration and the entire federal  
1 government today is that large businesses are receiving<sup>68</sup>  
2 small business procurement awards, and agencies  
3 receiving credit for those awards.

4 That doesn't sound good. That doesn't sound  
5 good to me. Who's responsible for that? Who's  
6 responsible for that? I think the SBA is.

7 There have now been seven government  
8 investigations and one private study that have found the  
9 SBA and other federal agencies have reported billions of  
10 dollars in federal contracts to some of the largest  
11 companies in the world, not just America, as small  
12 business awards.

13 This misleading data has projected a false  
14 impression that federal government has reached  
15 congressional mandate 23 percent small business  
16 contracts involved.

17 So, clearly, it's a major problem with the  
18 Small Business Administration and the way these programs  
19 are administered today.

20 This is not my opinion. This is the opinion  
21 of the General Accounting Office, the SBA's own  
22 Inspector General, the SBA's Office of Advocacy and  
23 Center for Public Integrity.

24 The SBA put this proposal up for public  
25 comment earlier this year. They got 6,000 comments, and

1 95 percent were against every single aspect of that<sup>69</sup>  
2 proposal. And there's two people in the country that  
3 have all those comments, the SBA and me. I've got them  
4 all. 95 percent were opposed to every single comment.  
5 That's very reasonable. 98 percent of all the companies



6 in America has less than a hundred employees.  
7 89 percent have less than 20. So it's very reasonable  
8 to see that kind of response. Small businesses don't  
9 need these types of changes.

10 I believe the SBA's worked very closely with  
11 special interest groups in Washington in these changes,  
12 because they both have the same goal. They both want  
13 large businesses to be considered small, so the SBA can  
14 report contracts to large companies to small businesses,  
15 and the small business get the contracts.

16 I sued the SBA in federal court here just down  
17 the street the other day. I won a federal case. An  
18 SBA --

19 MR. KLEIN: Does this relate to size?

20 MR. CHAPMAN: Yes, it does.

21 MR. KLEIN: Because I'm confused.

22 MR. CHAPMAN: You're confused? I'll explain it to  
23 you, okay. You're talking about changing size  
24 standards, right? And you're taking public comment on  
25 proposed grandfathering, aren't you, right? Okay.

1 You're taking public comment on proposal to have an  
2 exception for venture capital companies. All right.  
3 Great.

4 So here's what your Office of Advocacy found.  
5 They found vendor deception, which here in California is  
6 the same as fraud. That's a felony with a ten-year  
7 prison term. Anybody want to guess how many people have  
8 been prosecuted for fraud in your lifetime? Zero.

9 The SBA Office of Advocacy found in their  
10 report they found companies like Raytheon, Northrup,  
11 Titan, VAG Systems, Perot Systems, Carlyle Group,

12 General Dynamics, EDS, Archer Daniels Midland, ITT  
13 Industries, SAIC, Oracle and Hewlett-Packard as small  
14 business awards.

15           So any size standards that would allow that to  
16 happen, I think, need to be changed immediately. And by  
17 the way, I personally don't trust that the people that  
18 wrote the size standards will allow that to happen.

19           The SBA's (inaudible) websites to protect  
20 small businesses. And be aware when these guys talk  
21 about small businesses, they are talking about ITT.

22           I see Hewlett-Packard on the wall there.  
23 Hewlett-Packard gets small business contracts today,  
24 right?

25           I've got a report here from the Social

1 Security Administration. AT&T is getting small business<sup>71</sup>  
2 contracts. Who did that? Who did that? Who is  
3 representing small businesses when they pass policies  
4 that allow the biggest companies on the planet to get  
5 small business contracts?

6           In September 2004, the Center for Public  
7 Integrity found the Defense Department alone awarded  
8 \$47 billion in small business contracts to some of the  
9 nation's largest defense contractors based on policies  
10 passed by the SBA. The Center for Public Integrity.

11           The SBA's own Inspector General viewed the SBA  
12 loan procurement practices, and in a report 514, the six  
13 largest small business contracts that the SBA awarded,  
14 here's what they say, their own Inspector General.

15           In reviewing a sampling of the six largest SBA  
16 small business contracts, Inspector General Damlen said,  
17 the SBA awarded four of the six high-dollar procurement

18 reported --

19 MR. KLEIN: Your time is up. You need to wrap it  
20 up.

21 MR. CHAPMAN: I will. Report 516 found large  
22 businesses were getting small business contracts through  
23 falsification and improper business certifications. And  
24 the grandfathering plan that they are proposing will let  
25 them continue.

1 Thank you. And gentlemen, I've been to six of<sup>72</sup>  
2 these things, and I know this is where you try to impugn  
3 my testimony, so I am declining to take any questions  
4 from the panel at this time. Thank you.

5 MR. KLEIN: You say you're not inclined to take any  
6 questions?

7 MR. CHAPMAN: I'm declining to take any questions.  
8 I was in D.C. when you made that French lady cry. Where  
9 you wouldn't let the lady in Chicago finish her speech,  
10 I was there. Okay. So --

11 MR. KLEIN: I don't remember any woman crying.

12 MR. CHAPMAN: I remember. I remember a lady in a  
13 red vest running down the hall crying.

14 MR. KLEIN: Thank you for your testimony.

15 MR. CHAPMAN: Thank you.

16 MR. JACKSON: Let me make a comment that in Chicago  
17 the person that Mr. Chapman talked about did not talk  
18 about size standards. Her testimony was on particular  
19 administration and policies of a program. And that was  
20 not part of the hearing, and we had to disallow her  
21 testimony. So it's not that we were not trying to hear  
22 from her or harass her in any way, but the issues that  
23 she rose were not pertinent to the testimony.

24 I do want to make one clarification, that the  
25 studies that have found large businesses reporting to  
1 have small business contracts, the IG reports, the 73  
2 General Accountability Office, the Office of Advocacy  
3 sponsored research by Eagle Eye, focus on the main issue  
4 or main reason for that as being GSA-scheduled  
5 contracts.

6 These are long-term contracts, where a company  
7 is awarded an initial contract for five years, and it  
8 can go on for as many as 20 with options. And that in  
9 many of the cases the companies outgrow the size  
10 standards are bought out. And in many of those cases,  
11 it's a reporting issue, and that companies are not --  
12 those large companies are not getting contracts away  
13 from a small business, because those contracts weren't  
14 set aside.

15 we have been working on this issue very  
16 diligently as a separate issue. We have made a number  
17 of changes wherever possible along the way.

18 And I will acknowledge that Mr. Chapman has  
19 been very helpful in working with us on that, and I  
20 sincerely appreciate his efforts. But this issue is  
21 something separate that we're dealing with, and we hope  
22 to have some future rulemaking actions later this year  
23 that hit, again, the issue about long-term contracts.

24 Again, I thank you, Lloyd, for your testimony.  
25 I did just want to clarify the context of many of these  
1 issues. 74

2 MR. CASTANUELA: Mr. Klein, I'm not on the agenda  
3 to speak, but I would like to make one quick comment. I

4 know this is beyond the normal for today. I came in  
5 from out of the region. I came in from Texas.

6 MR. KLEIN: Your name, please.

7 MR. CASTANUELA: Elio Castanuela. I'm president of  
8 a company, Diversified Technical Services.

9 But I didn't come to listen to people make  
10 complaints about issues other than in size standards.  
11 And I would ask, since you've been introduced as a  
12 moderator, if there is anything we can do to keep the  
13 subject on size standards, or else I'll catch an early  
14 flight back to El Paso.

15 we all have problems in businesses and all, in  
16 establishing our business with the SBA, with  
17 regulations, with the contracting officers. But today  
18 we're supposed to be talking about size standards, and  
19 so I would like to hear some of the speakers talk about  
20 size standards and not about their own little business  
21 problems. We've all had that. Thank you.

22 MR. CHAPMAN: Excuse me, but --

23 MR. KLEIN: Mr. Chapman, you've spoken. Let's take  
24 a quick break and come back in ten minutes.

25 (Recess taken from 10:12 to 10:35 a.m.)

75

1 MR. KLEIN: Isabel de la Torre?

2 MS. DE LA TORRE: Hi, I am Isabel de la Torre from  
3 Puerto Rico. And I feel very concerned for the  
4 situation of the size standards.

5 I've been a member of the SBA for three years  
6 now, and we have been sending proposals back and forth.  
7 It's been very hard, and we have never gotten any  
8 project yet.

9 I think that the idea of the small business is

10 about all the big business made of small business.  
11 Isn't that the principle? And we have a very  
12 interesting case in Puerto Rico. After -- and this has  
13 a lot to do with the size.

14 Puerto Rico lately has been changed from  
15 domestic to international. What happened there is that  
16 all the budgets that came from the federal government to  
17 Puerto Rico, they have diminished.

18 So now what happens is that the small  
19 businesses have less business, and all the big business  
20 get more business. Especially, we're an island. We're  
21 a hundred by 35 miles. We have the little suppliers  
22 that do the same things. So our suppliers prefer to do  
23 business with the bigger business, than to do business  
24 with the small business, because they will get more  
25 business from the bigger business.

1 This is something very important for us to  
2 consider today. I traveled 14 hours to be here today  
3 and I am very glad.

4 We find an ethical problem about the sizing.  
5 And my business is advertising and communication. And I  
6 really would like for us to -- the people are here to  
7 think about the ethical problem, about what is big and  
8 what is small.

9 We Small Business Administration would help  
10 the small business get a little bit bigger, but we are  
11 small. So how do you get bigger? How do you make a  
12 proposal and know that if you're going to get bigger,  
13 you need suppliers and you need to get bigger and you  
14 need capital? But before capital, you need the clients.  
15 So it's like what came first, the egg or the chicken?

76

16           So I think that it's very important for all  
17 small businesses to be together and become like a big  
18 business of small businesses in a way to support each  
19 other in helping with the proposals and getting in touch  
20 with each other. Communication is really important for  
21 us. So we know it's really happening to all of us.

22           I know this is San Francisco, we are in Puerto  
23 Rico, and it's many different things, and it's not about  
24 blacks or Hispanics or anything. It's about business  
25 and how the government -- the government is here to help

1 us. And we are here to help the government because we<sup>77</sup>  
2 are the people.

3           And I am just here just to let you know what's  
4 happening to my island because monopoly is coming over  
5 us and the small businesses are just closing.

6           Puerto Rico is a very, very -- we have the  
7 Macy's that sells more in the world. We have the Home  
8 Depots that sells more in the world. We have 15 million  
9 tourists going to my island that four million people  
10 live there. Just these things are happening, and it's  
11 important to think about, not just with the mind but  
12 also with the heart, you know, what can we really do?  
13 Because we all started small, you know, and we all want  
14 to get bigger.

15           We're here because we are hardworking people.  
16 We want to make things happen. We're not here because  
17 we want the government to support us. We're here  
18 because we want to work. We want business. We want  
19 things to grow. We want things to happen.

20           And, you know, I hear about larger getting  
21 larger and -- but after you see all the business models,

22 small is what works. Small business is what really  
23 works. Everybody wants the personal attention.  
24 Everybody wants to be there.

25 I think we should have some sort of incentives  
1 for the small business to be able to be there. I think<sup>78</sup>  
2 there must be policies to help. And I'm just here to be  
3 a mediator in a way, because good business is business  
4 that is good for everybody.

5 MR. KLEIN: Can you make specific recommendations  
6 regarding standards themselves, or employee versus  
7 revenue, or any of those issues?

8 MS. DE LA TORRE: I think you already have the  
9 reason. We became part of the SBA because we already  
10 have standards, and we all fill out the applications and  
11 did everything based on the standards what they are.

12 MR. KLEIN: So you think the current standards are  
13 sufficient?

14 MS. DE LA TORRE: Yes, definitely.

15 MR. KLEIN: Thank you. Tom Lease?

16 MR. LEASE: My name is Tom Lease, that's L-e-a-s-e.  
17 I'm with NBA Engineering, a mechanical engineering firm  
18 in San Francisco and Oakland.

19 I'll keep it simple. Small Business  
20 Administration, that means small business, which to me  
21 small is less than a hundred employees for a service and  
22 less than 500 for manufacturing. We've gone on to make  
23 it harder than it really is.

24 If you start ratcheting it up, what's the  
25 point to call it the medium business administration or

1 large business administration. We can bring a dog to my<sup>79</sup>  
2 work, a large dog to a small company. Maybe that should



3 be part of the program as well.

4 Any questions?

5 MR. KLEIN: So you prefer employees versus  
6 revenues; is that correct?

7 MR. LEASE: Yeah, I would prefer that. That's  
8 correct.

9 MR. KLEIN: And how about the equivalent issue,  
10 where do you fall on that, full-time equivalent versus  
11 the way we currently do things?

12 MR. LEASE: Full-time, I believe you should be  
13 full-time employed. Count that. Part-time, if you want  
14 to use two part-time jobs as a way of getting around  
15 paying a living wage and benefits. So there should be  
16 actually maybe, you know, whatever way would aid the  
17 employee instead of the corporation.

18 MR. JACKSON: Just a follow-up question. Number of  
19 employees is how we've asked questions of other people  
20 who have testified, on if there's a burden in providing  
21 information.

22 Do you have accounting systems and payment  
23 systems that you can easily verify your count of number  
24 of employees? Or do you feel that that's something we  
25 need to look into, if we moved to an all-employee size

1 standard structure?

2 MR. LEASE: Well, I think that you have payroll  
3 records. It would be pretty readily available and  
4 verifiable.

5 And I would urge the SBA also to -- I saw a  
6 lot of loophole things on another -- sorry to get off  
7 base here, but there seems to be a lot of fraud or  
8 jumping through loopholes that I would encourage the

80

9 size standards, whatever they are be adopted, that they  
10 are enforced, that there's some teeth in the  
11 enforcement.

12 MR. KLEIN: Obviously, SBA agrees with that. There  
13 is an appropriate mechanism, as Gary has talked about  
14 before, for any particular contract, any interested  
15 party may protest the size. That's at the award stage.

16 As you heard testimony this morning, some have  
17 concerns about firms being counted as small even after  
18 they have been acquired, et cetera. SBA also shares  
19 that concern, and we are working to fix that issue as  
20 well. So we understand what you are saying.

21 Thank you.

22 MR. LEASE: Thank you.

23 MR. KLEIN: Randy Clark?

24 MR. CLARK: My name is Randy Clark. I represent a  
25 company called Grayback Forestry. We're located in

1 Grants Pass, Oregon. I also represent an environmental<sup>81</sup>  
2 association, the National Environmental Fuels  
3 Association, out of Eugene, Oregon.

4 We're primarily a fuels management and  
5 firefighting company, and we live and die in the  
6 government procurement field, and particularly in the  
7 indefinite delivery and indefinite quantity field, which  
8 is a real issue with us when we begin to look at  
9 revenues and so forth.

10 We had the opportunity to review the SBA's  
11 March 19th, 2004 proposed rule for restructuring, as  
12 well as study the Advanced Notice for Proposed  
13 Rulemaking.

14 And based on our analysis, we are prepared to  
Page 66

15 offer some comments and some suggestions as they pertain  
16 to the methods used in calculating size standards for  
17 small businesses.

18           First of all, it's our strong opinion that  
19 change from a receipt-based standard to a number of  
20 employee-based standard makes the most sense; in many  
21 ways simplifies the determination process.

22           It is also our opinion that change from  
23 receipt based to number of employees with a maximum  
24 annual receipt will complicate the determination process  
25 and in some ways create an artificial ceiling that small

1 businesses are faced with the reality of real-world  
2 economics.

3           The primary tool used to calculate the  
4 equivalents, the employee size standards with recipient  
5 based -- receipt-based standards that the SBA has  
6 proposed is probably the best method they could have  
7 chosen. This method allows for normal fluctuation to  
8 the economic business cycle, without disruption of the  
9 operational cycle.

10           The single best reason for converting to an  
11 employee-sized based standard is the fact that the  
12 number of employees in a company does not vary with  
13 changing economic conditions as radically as do  
14 receipts. Inflation and rising costs would not have a  
15 direct impact on employee sizes.

16           Small business owners tend to have a strong  
17 commitment to their employees, and strive to maintain a  
18 stable workforce. Most small businesses try to avoid  
19 the high cost of training new employees in order to meet  
20 short-term production or service needs.

21           In order to meet short-term needs, companies  
22 tend to introduce overtime, production methods or  
23 changes rather than hiring new employees.

24           With a company's real output of goods and  
25 services changed, an employer would be faced with the

1 addition of new employees. This becomes a management  
2 decision that can be an informed decision, knowing full  
3 well what the results of that decision will be in  
4 regards to size classifications of the business, which  
5 is something that cannot necessarily be determined when  
6 we're looking at solely receipt-based size  
7 determinations.

8           When I make a decision based on a production  
9 line or taking on a contract, and particularly when it's  
10 an indefinite quantity, indefinite delivery contract, I  
11 really cannot determine on a three-to-five-year contract  
12 what my receipts are going to be, which creates a  
13 tremendous problem. I can also then adjust my  
14 workforce.

15           On March 19, 2004, the proposed rule SBA  
16 expressed concerns about businesses operating in  
17 industries that have a greater latitude in  
18 subcontracting significant portions of their work in  
19 order to stay underneath the employee size standard.

20           And our response to that is we feel that  
21 subcontracting is a good thing. In most cases  
22 subcontracting is going to be done with other small  
23 businesses that do not have the ability to deal with the  
24 government on some levels of accounting, some levels of  
25 procurement and so forth. And the trickle-down effect

83

84

1 allows other small contractors to take a portion of that  
2 work and allow the main contractor to deal directly with  
3 the government in regards to those contracts.

4 It's our recommendation that the SBA propose a  
5 restructuring of the size standard based strictly on the  
6 number of employees. Proposed employee size standards  
7 as set forth in the March 19, 2004 proposal are  
8 adequate. It's further our recommendation that the  
9 current SBA classification of employees be retained.

10 However, we do feel that the average number of  
11 employees should be based on a 36-month rolling average.  
12 Currently, the receipts are based on a 36-month rolling  
13 average, and I'm not sure that it shouldn't be the same  
14 type of calculation in order to allow for short-term  
15 changes and short-term consideration in the marketplace,  
16 and allow employers to make adjustments over time rather  
17 than to meet a particular situation.

18 In today's electronic age, the tracking of the  
19 average number of employees should be just as easy to  
20 calculate as revenues based on numbers of employees.

21 That's my comments.

22 MR. KLEIN: Regarding employees, were you basing it  
23 on your industry or across the board?

24 MR. CLARK: I'm speaking for our industry. But I  
25 think as I look at and have been involved in a number of

1 these discussions for probably the last five years or 85  
2 so, in regards to -- I have even suggested as much as  
3 five years ago that the SBA look across the board and  
4 going instead of just in the manufacturing end of it  
5 with employees, as well as the service industry, that I  
6 think it needs to come clear across the board.

7 MR. JACKSON: Mr. Clark, I'm familiar somewhat with  
8 your industry, and I know that your industry has a lot  
9 of seasonality to it. There's also high turnover, a lot  
10 of part-time people. You don't feel that those  
11 characteristics in your industry make it more difficult  
12 for you to track number of employees as compared to  
13 averaging those needs?

14 MR. CLARK: I don't think so, because like I say,  
15 with the electronic, with the ability to capture  
16 computers today and capture number of hours that people  
17 are working, and particularly if we do it on a 36-month  
18 rolling average type of situation, it gives us plenty of  
19 time to run those numbers and to see where we are.

20 I can't imagine anybody not being able to know  
21 how many hours people are working. They're running  
22 payroll systems, and all of those numbers can be  
23 extracted right from the payroll system.

24 MR. JACKSON: Going back three years is not asking  
25 companies to keep historical information that they would

1 otherwise not retain? Is that going back too far or is<sup>86</sup>  
2 that standard?

3 MR. CLARK: Perhaps. And my thoughts were that  
4 it's a situation where you've got to have a starting  
5 point, if we go back three years. If you make the rule  
6 change, if the rule changes, goes to strictly number of  
7 employees based on a 36-month rolling average, do you  
8 start at that point and go forward or do we go back? I  
9 can't answer.

10 I know for my company and the number of people  
11 in our -- companies in our industry, could do that. So,  
12 yes, we are -- you know, just in a real situation where,

13 like I say, the indefinite quantity, indefinite delivery  
14 contract.

15 And what has happened with the SBA, the  
16 government has grown us through the ceiling, and the  
17 ceiling doesn't keep up. So what happens is, if we  
18 punch through the ceiling there's nobody to take our  
19 place, or those people that are coming along.

20 And what has happened is, we've looked at  
21 situations where agencies, government agencies would end  
22 up dealing with 75 to a hundred different contractors to  
23 fill the place of some of these companies that are  
24 growing through the ceiling, where the agencies have  
25 told us time and time again they would rather deal with

87

1 companies that can take on the business and then  
2 subcontract it down so they have a more limited focus on  
3 the dealing and controlling those particular contracts.

4 MR. JACKSON: Thank you.

5 MR. CLARK: Thank you.

6 MR. KLEIN: Elizabeth Gallagher?

7 MS. GALLAGHER: I'm Elizabeth Gallagher, and I'm  
8 from Las Vegas. I'm a general contractor. I own Savvy  
9 Construction. I am also with the United States Hispanic  
10 Chamber out of Washington, D.C. I'm the regional chair  
11 for the seven western states. And I'll give you my view  
12 on this.

13 I want to, first of all, thank you for  
14 allowing me the opportunity to testify at this hearing  
15 regarding the SBA's desire to reform the size standards  
16 by which small businesses are formally defined by the  
17 federal government.

18 The SBA wants to reform the size standards.

19 SBA's proposal for reform was not well-conceived and  
20 would have reclassified thousands of small businesses.  
21 Many might have lost their 8(a) status, their SBV  
22 status, their small business status, et cetera.

23 SBA size standards affect the ability of all  
24 small businesses to participate in contracting in the  
25 federal sector local levels of government and in the

1 private sector.

88

2 The present interest. The concern is over the  
3 possibility that the SBA might implement size standard  
4 reform in a manner that could adversely affect the large  
5 numbers of the small businesses opposed to a pressing  
6 need to reform size standards.

7 In the past, the SBA recommended that there be  
8 ten size categories instead of 37. When one considers  
9 the extraordinary depth and breadth of businesses in our  
10 economic system, ten size classifications is probably an  
11 insufficient number.

12 Leave the size standards as they are, some  
13 based on revenues and some based on employees, but  
14 reduce the number of sizes from 37 different sizes to a  
15 lesser number. Perhaps a suitable number of  
16 classifications is more like 20.

17 Revenue and employees. There are logical and  
18 meaningful reasons to have standards based on employees  
19 in some industries and size standards based on revenues  
20 in other industries. Some industries, for example, rely  
21 heavily on part-time employees, consultants and contract  
22 workers as compared to full-time employees.

23 In regards to construction, all contractors  
24 should be at one size standard. Reason being that most



25 specialty contractors grow and become prime contractors,  
1 perform multiple scopes. As a specialty contractor, and<sup>89</sup>  
2 most general contractors self-perform specialty  
3 construction work, even though they are a general  
4 contractor.

5 The cost of construction labor has increased  
6 dramatically over the past five years and greatly in the  
7 past two years. The cost of materials, including  
8 concrete, copper wire, drywall, lumber and steel, just  
9 to name a few, has increased as much as 50 percent, yet  
10 the size standards have not increased with the changes  
11 in the economy.

12 A suggestion would be to have one size  
13 standard for all construction at 150 million, and should  
14 also have a yearly increase for inflation and cost of  
15 living. To simplify the size standards, the SBA should  
16 return to their definition of small businesses that has  
17 a hundred or fewer employees. This definition is clear  
18 and simple.

19 By returning the nonmanufacturing size  
20 standards to 100 employees from 500, the SBA will allow  
21 23 million small businesses a fair and equitable  
22 opportunity to bid and win government contracts.

23 The Small Business Act of 1953 defined a small  
24 business as one which is independently owned and  
25 operated and not dominant in its field of operation.

1 The SBA needs to reflect on the definition and realize<sup>90</sup>  
2 that against the founding purpose, they have willfully  
3 allowed publicly-traded firms dominant in their field of  
4 operation to acquire billions of small business  
5 contracts and thus knowingly inflated small business

6 government contracting numbers.

7           For the construction industry, we are not in  
8 favor of calculating numbers of employees to determine  
9 the size standards. In the construction industry  
10 calculation the number of employees would not be  
11 consistent measuring the size for a company. Therefore,  
12 a recommendation that the size standards for all  
13 construction scopes be 150 million based on 5 percent of  
14 average revenue of the top ten construction companies;  
15 and personal net worth should be changed to 7.5 million.

16           Thank you very much for your time. Any  
17 questions?

18       MR. JACKSON: Couple of quick questions. First of  
19 all, 150 million, that was a fairly large jump in our  
20 current size standard. Do you think that would  
21 adversely affect the opportunities of many smaller  
22 businesses?

23           We've had some testimony here today, but in  
24 other hearings concerns by companies with anywhere from  
25 a handful of employees to 20 to 30 employees.

1       MS. GALLAGHER: The problem is that if you put the<sup>91</sup>  
2 cap at a smaller amount, I myself, as a general  
3 contractor, cannot get any government jobs because most  
4 of the government jobs are being bundled together.

5           So, therefore, there would be no possibility  
6 of me -- there was a job at the Pentagon that came up,  
7 and instead of taking it and cutting it up into  
8 different segments of maybe specialty trades, they  
9 lumped it all together and it was \$301 billion. So  
10 there is no way that --

11       MR. JACKSON: Million or billion?

12 MS. GALLAGHER: Billion. That was one job. So  
13 what we were trying to do, we were working with the  
14 Pentagon, asking them to please take part of it -- all  
15 we asked for was maybe take \$180 million of that job and  
16 let it go out to, you know, private general contractors  
17 that weren't so large, and maybe taking -- giving  
18 \$10 million to one, 20 million to another, so on and so  
19 forth.

20 So that's why we put the \$150 million, because  
21 in a job like that, you could take 150 million and it  
22 wouldn't necessarily go to one general contractor. It  
23 would be dispersed in specialty.

24 (Inaudible) diversity program in Las Vegas,  
25 it's done by the MGM Mirage. And I know you guys are

92

1 very well aware of that, because we have done SBA  
2 matchmaking there. And I'm the first Hispanic general  
3 woman contractor to get a job there. And the only way  
4 that we were able to actually start getting jobs is that  
5 we said take a portion of what you're going to be  
6 building and go ahead and put this in this area.

7 Now, I only got a job for \$54,000, but I at  
8 least got my foot in the door, as opposed -- and they  
9 had taken that from a portion of \$80 million that they  
10 put out there, that they're giving to a diversity  
11 program.

12 MR. JACKSON: Another question. Earlier in your  
13 testimony you seem to suggest size standards in many  
14 areas were acceptable, but the number of  
15 classifications.

16 Are you suggesting that SBA should not  
17 exclusively establish size standards by (inaudible) or

18 classification systems, but should look at broad  
19 categories? Or am I missing the point on what you were  
20 referring to there?

21 MS. GALLAGHER: On the size standards, let me make  
22 sure I say it properly here. Let me see. Basically,  
23 what we were looking at is on the size standards that  
24 they not be put into one category, that they should --  
25 the size standard should basically be according to the

93

1 different industries.

2 MR. KLEIN: Thanks.

3 MS. GALLAGHER: Thank you so much. And thank all  
4 of you for being here.

5 MR. KLEIN: Martha Bennett? Aida Caputo?

6 MS CAPUTO: Good morning. My name is Aida Caputo.  
7 First name, A-i-d-a, C-a-p-u-t-o. I am the DBE program  
8 administrator for the Golden Gate Bridge Highway and  
9 Transportation District. The Golden Gate Bridge Highway  
10 and Transportation District, a recipient of federal  
11 financial assistance, is required to administer a  
12 federally approved disadvantaged business enterprise  
13 program.

14 In order for a firm to participate in a DBE  
15 program, the firm must meet the Small Business  
16 Administration size standards.

17 Because of the district's commitment to its  
18 DBE program, I have been requested to come here today on  
19 behalf of our board of directors, to speak about the  
20 importance of ensuring that DBEs are not unduly  
21 disqualified from participating in the DBE program as  
22 the result of the use of a business size measurement  
23 that does not take into consideration an important

24 factor: The high cost of living in certain geographical  
25 areas of the country such as the San Francisco Bay Area.

1           The cost of living in the San Francisco Bay 94  
2 Area continues to be one of the highest in the country.  
3 Higher cost of housing, utilities, transportation and  
4 other expenditures make it more costly for small  
5 business owners to live and own their businesses in the  
6 Bay Area.

7           In addition, higher labor, office space and  
8 tax expenses make it more costly for the small business  
9 owners to operate a business and compete successfully.

10          The district urges SBA officials to consider  
11 the challenges faced by the small businesses based in  
12 the San Francisco Bay Area as well as other geographical  
13 areas in which high costs of living exists when making  
14 its decision on how best to simplify and restructure its  
15 size standards. In this way the true intent of the  
16 program can be advanced even within such expensive areas  
17 as this.

18          Thank you.

19          MR. JACKSON: Quick question. If we went to a  
20 geographical-based system, wouldn't that complicate size  
21 standards more? Or are you suggesting the benefits  
22 outweigh the added complications of the system?

23          MS CAPUTO: Right now what we are using is an  
24 annual gross receipts. We can take into account the  
25 expenses.

1          MR. KLEIN: James Putnam?

2          MR. PUTNAM: Good morning. My name is James  
3 Putnam. I'm director of federal programs for MKM

4 Engineers. We are headquartered in Houston, with  
5 regional offices in Albuquerque, Ohio and Sacramento. I  
6 work in the Sacramento office.

7 I worked for MKM for just over a year. Prior  
8 to that I was with the Air Force and the Navy as a  
9 contracting officer and program manager for 31 years.  
10 Among my duties was an assignment as the small and  
11 disadvantaged business utilization specialist for  
12 Hawaii.

13 I bring this perspective to the hearing of  
14 both the government procurement personnel and their  
15 activities and small business contractors.

16 MKM graduated from the 8(a) program on the  
17 19th of May this year. That journey started with two  
18 men and a credit card, and with the critical assistance  
19 of SBA led us at graduation to be a vital company with  
20 140 employees, \$40 million in revenues. Our business  
21 primarily involves environmental remediation services  
22 provided to U.S. government agencies and some commercial  
23 clients.

24 I'd like to use our story to demonstrate how  
25 changing size standards would be injurious to our firm

1 and to others like us, and not serve the interest of the<sup>96</sup>  
2 government business communities or the clients we serve.

3 MKM started doing small projects in what could  
4 be termed traditional environmental remediation, soil  
5 and water cleanup. During our 8(a) tenure, we continued  
6 developing the engineering and remediation capability to  
7 develop businesses and radioactive waste remediation,  
8 explosives, contaminated building decontamination and  
9 unexploded ordinance remediation.

10           we decreased reliance on noncompetitive awards  
11 in transition to competitive awards, with 80 percent of  
12 our current work resulting from competition. The result  
13 is that we are now successfully competing for contracts  
14 as a small business.

15           Most notably, we were recently awarded an  
16 \$18 million delivery order for guaranteed fixed price  
17 remediation with insurance services at Joliet Army  
18 Ammunition Plant by the Army Corps of Engineer's  
19 Louisville district, under their small business multiple  
20 award remediation contract, IESQ.

21           This is, essentially, a turnkey cleanup  
22 project at a number of sites, with planning,  
23 engineering, remediation, traditional contamination plus  
24 an explosives component to it. We have similarly been  
25 recently awarded work at former McClellan Air Force Base

1 for low-level radioactive waste remediation, and this <sup>97</sup>  
2 follows up on similar work we're doing at Hunter's Point  
3 Naval Base, as it's closed in San Francisco.

4           The point to my story is that to be an  
5 effective business in the environmental business there  
6 is a need for diverse support staff of engineers,  
7 scientists, safety managers, in our case including  
8 specialized safety for explosive and radiation,  
9 regulatory compliance experts and construction managers.

10           Added to site managers and site workers, a  
11 100-employee standard or low-dollar revenue size  
12 standard would keep MKM limited to its initiatives in  
13 this line of business and prohibit us from growing to a  
14 full-service environmental service provider.

15           Further, we would be forced to transition from

16 our 8(a) status directly to a large business, pitting us  
17 against some of the very large and global providers of  
18 similar services. Our only choice, then, would be to  
19 compete for subcontracts, or remain as the prime  
20 contractor to retreat to one of our niche business  
21 lines.

22           The current small business size standard has  
23 allowed procuring agencies a pool of competent companies  
24 available for competing on midrange projects in the five  
25 to \$25 million range.

98

1           For MKM, and others like us, the current  
2 500-employee size standard allows us to grow to our  
3 potential and to pursue work as a prime contractor with  
4 the associated risks and rewards.

5           The previous adoption of the multidiscipline  
6 standards in the environmental remediation area has been  
7 effective and allowed us to grow and compete in an  
8 ever-changing business climate.

9           With the current focus on performance-based  
10 contracting and guaranteed fixed-price remediation, much  
11 of the environmental remediation work is coming out in  
12 larger procurements that the very small, that is to say,  
13 under a hundred employee firms, just will not have the  
14 technical capacity or probably the financial capability  
15 to compete.

16           The continuing work for closed and realigned  
17 military bases is the best example where agencies are  
18 going in their acquisition approaches of  
19 installation-wide contracts utilizing broad scopes of  
20 work, multidiscipline-type work.

21           To be effective in this type of procurement,



22 in environmental remediation services generally the  
23 standard must be maintained to ensure meaningful  
24 participation by small businesses to be overall  
25 government targets.

1 I would just add as a final comment that as an <sup>99</sup>  
2 8(a) contractor, in some of the NAICS codes we were  
3 qualified as an 8(a) contractor and in other parts of  
4 the environmental business where there were size  
5 standards between four and \$12 million, on any given day  
6 we could be contacted by contracting officers as an 8(a)  
7 contractor, a small business or a large business.  
8 Simplifying them would help.

9 Is there any questions?

10 MR. KLEIN: In terms of those varying size  
11 standards, does it make sense that these related types  
12 of entries should have similar standards, or do you  
13 think they work the way they are?

14 MR. PUTNAM: I think it ought to be employee based  
15 rather than revenue. I think --

16 MR. KLEIN: In the environmental, I know sometimes  
17 it's under a need, sometimes it's under a separate -- it  
18 can go back and forth. Is there a problem with that or  
19 is it working okay?

20 MR. PUTNAM: I think in March 2004 the rule that  
21 put in the 522910 environmental remediation standard,  
22 that said if you're working in a couple of these, that  
23 was really the savior. That's the standard that we  
24 would like to preserve.

25 I think that that approach would apply to

1 other -- some of the engineering and construction  
2 disciplines may be able to do that. A \$4 million size

3 standard in some of the niche business that we do up to  
4 \$12 million dollars, for example, in the engineering  
5 services and 54 class, or some of the HTRW waste  
6 management categories, it gets confusing to contracting  
7 officers. Then you have to sit and figure out what's  
8 the predominant piece of the work.

9           And in some cases, it may not be predominant  
10 if you've got three or four different -- To clean up a  
11 site at Hunter's Point or McClellan, you have a lot of  
12 different disciplines to choose from, and it becomes  
13 confusing, and also raises the risk of protest even  
14 though contracting officers are trying to exercise their  
15 best judgment.

16           MR. KLEIN: Thank you.

17           Ross Barrons?

18           MR. BARRONS: Good morning. My name is Ross  
19 Barrons. I am the controller of ChemoCentryx,  
20 C-h-e-m-o-c-e-n-t-r-y-x. We are a biotechnology company  
21 here in the Bay Area. I am here to go back to size and  
22 the SBIR program. And I don't want to reiterate all of  
23 the testimony that was given earlier today. I do want  
24 to answer some of the questions that were posed by the  
25 panel. The first being around corporate governing.

1           I don't think that's necessarily an area that<sup>101</sup>  
2 you would want to go into. In the case of our company,  
3 our board was dominated by the common shareholders. We  
4 would have qualified as an SBIR contractor if you had  
5 used that as the standard.

6           In the case of ChemoCentryx, we were actually  
7 awarded \$1.3 million worth of SBIR grants that I had to  
8 turn down because we are -- we have venture capital

9 money.

10           And it's interesting, if you're going to  
11 create an SBIR program to go out and do research and  
12 encourage research in small companies, you get your  
13 first round of funding, you qualify because usually  
14 you're founding scientist has 50 percent of the shares  
15 of the company, whoever is putting up the money has  
16 50 percent. You qualify.

17           Now what happens, you get your second round of  
18 funding, it has to come from VCs. You cannot go to  
19 individuals and get the kinds of money that biotech  
20 needs to develop drugs from individuals.

21           Alex Zaffaroni is an interesting example.  
22 Alex came to this country from Mexico with Syntex. When  
23 he first came to the United States, he wasn't a U.S.  
24 citizen. He wouldn't have qualified for an SBIR loan or  
25 grant under the rules as you have them set out right

102

1 now.

2           It's interesting. As a company matures and it  
3 becomes public, you can make the argument that now under  
4 your current rules under the street that they would then  
5 qualify for SBIR grants.

6           So what you have is a situation where real  
7 small businesses now don't qualify for a program that  
8 you're trying to encourage. And that's where you've got  
9 to figure out -- and I don't envy your job, because  
10 hearing all of the people talk here today, somebody is  
11 going to end up being a small business and somebody is  
12 going to end up not being a small business. And good  
13 luck to you on figuring out where that line is.

14           I think where you've got a real issue is where

15 you have a program like SBIR and you have the sizes, you  
16 need to make sure that those two things are working in  
17 common with each other and that they have common purpose  
18 and goals. Otherwise, you are going to undermine your  
19 own program.

20 And I'll take any questions, or if anybody  
21 else that's from the biotech community wants to answer,  
22 I would be happy for that.

23 MR. KLEIN: How about what I asked before. We have  
24 heard throughout these testimony, hearings, that the  
25 firms who get SBIR grants are more in the early stages,

1 and once you get to the VC stage, you are beyond that. 103

2 Is that not true?

3 MR. BARRONS: In biotech now, as soon as you get  
4 your -- assuming that your founding partner gets  
5 50 percent of the shares, you're very good.

6 Most biotech companies have less than a year's  
7 worth of cash on hand now. And as the market window  
8 gets tighter, you have less and less cash. So,  
9 basically, what you're saying is that somebody might be  
10 available for the first year, year and a half in a  
11 biotech company eligible for SBIR, and then not eligible  
12 any longer.

13 well, our company started in '97. We still  
14 don't have our first product in market. We're looking  
15 to have it in market in 2008. And we will have had to  
16 have funded all of that development somehow. And you're  
17 looking at a very, very narrow window of that time  
18 horizon, if you keep the standards the way they are.

19 MR. PACCIONE: I have a question, but I just wanted  
20 to mention, because I think it's pertinent on this, the

21 SBIR program is based on research and development.

22 SBA, believe it or not, has a program called  
23 the certificate of competency program, I just wanted to  
24 mention, which that's really set up to help small  
25 businesses if a contracting office does not want to make

1 an award due to lack of financing or capability. And we<sup>104</sup>  
2 do get quite a few SBIR referrals to the SBA. And we  
3 take a second look at it. We can ensure we can fight  
4 for them and make sure the award is made.

5 So I was just, as a little bit of background,  
6 trying to help here with the point you're making that  
7 it's research and development, and we help all small  
8 businesses in any area.

9 MR. BARRONS: Now, what you're asking is for  
10 somebody at NIH, who basically is doing a scientific  
11 review, to come back and do an appeal. And we actually  
12 asked about that when we had to reject our first sets of  
13 grants. And when they went to the SBA, they were told  
14 that, no, we wouldn't qualify.

15 So we actually did go through the appeal  
16 process that you're talking about and got a no answer  
17 even then.

18 MR. PACCIONE: Based on not maybe meeting the size  
19 standard you are talking about.

20 MR. BARRONS: Yes. We are at 35 employees. By  
21 anybody's definition, we are a small business. We are  
22 35 employees. You know, we've got less than \$12 million  
23 worth of burn in that first year that we got that grant.  
24 Anybody looking at us would have said we are a small  
25 business.

1 And yet because of this one provision that  
2 somebody at the Office of Hearing and Appeals created --  
3 it's not in the legislation, it's something that  
4 somebody within the office created -- we don't qualify.

5 MR. PACCIONE: But my question, I wanted to ask  
6 you, what do you think about the affiliation rules?

7 In other words, let me put it like this. We  
8 all probably agree we do a small business set aside and,  
9 let's say, as an affiliation that General Motors owns a  
10 hundred percent of the small business.

11 I think we would all sit here and say, well,  
12 that doesn't seem right. They should not -- General  
13 Motors, bottom line, should not benefit from a small  
14 business.

15 As you pointed out, it gets so complicated  
16 because now it's not 100 percent and it's not General  
17 Motors. Maybe there's 20 different venture capital and  
18 we get into all these -- Do you have any comments that  
19 say if we relaxed the rules on affiliation with the  
20 venture capital, where would you point us in a  
21 direction?

22 MR. BARRONS: I think the original question was are  
23 there certain VC funds that are specific to  
24 pharmaceutical companies? We know who those are. I  
25 think it would be easy for me as the corporate secretary

1 to certify that my VCs are broadly held VCs as opposed<sup>106</sup>  
2 to company (inaudible) VCs.

3 That goes back to your original question.  
4 Yes, I can certify that my VCs got their money from  
5 broad categories. And, you know, if the question is of  
6 control, then I can say that my VCs don't control my

7 board and they don't control the direction of the  
8 company.

9           They wouldn't have invested in us if they  
10 didn't like what we were doing or like the way the  
11 management was running the company. So I really stay  
12 away from control. The lawyers can create --

13       MR. PACCIONE: Those are the issues we have to look  
14 at; that's why it's so complicated.

15       MR. BARRONS: Absolutely. I don't envy your job at  
16 all. You do have an SBIR program. It is designed to  
17 get new drugs into the clinic, and yet with your size  
18 criteria you have eliminated the bulk of the companies  
19 that are going to do that.

20           Bio had a survey at the end of last year that  
21 literally said that 62 percent of the private companies,  
22 private biotech companies, are no longer applying for  
23 SBIR grants, and that -- what was it -- 70 percent of  
24 them had applied at one time and the bulk of them now  
25 are being rejected.

1       MR. KLEIN: If we considered an exclusion from  
2 affiliation, could it be based on SBIR only, or would  
3 you want it beyond that?

4       MR. BARRONS: No, it would be SBIR only, I think,  
5 because that's the program that's being severely  
6 impacted by this.

7           If I go over to NIH and I'm trying to get a  
8 U19 grant, the SBIR criteria don't apply. So it's  
9 specifically within the SBIR program.

10       MR. JACKSON: A different question. At other  
11 hearings we've heard from companies that received SBIR  
12 grants that are concerned that if companies that are

107

13 majority owned by VCs are eligible for the program, that  
14 the program may shift more towards awards to those type  
15 of companies than companies that don't have VC backing.

16 Are there other alternative finances in the  
17 biotech area that make the SBIR program unnecessary for  
18 companies that have that level of VC participation?

19 MR. BARRONS: Two points on that. The answer --  
20 the easy answer is no, there's not. If you're going to  
21 develop a drug that costs, and the average drug to  
22 develop now costs \$800 million, there isn't another  
23 source besides VCs and the public markets. The  
24 government grants are not going to be enough to do that.

25 The other thing that I would say is, the VCs  
1 employ lots of high-caliber scientists in doing their <sup>108</sup>  
2 analysis. And I don't know that I would -- as a person  
3 and as a taxpayer, I don't know that I'd want my  
4 government giving money to a biotech company that didn't  
5 have VC money in it, because that would tell me that  
6 after somebody did due diligence, that the quality of  
7 their science wasn't good enough. And I doubt seriously  
8 that even if they took it to NIH, that they would get it  
9 approved.

10 MR. KLEIN: This is a follow-up to your other  
11 question. I remember at the last hearing someone was  
12 saying that the likelihood of success for an SBIR award  
13 increased by the number of proposals submitted, and the  
14 VC-backed firm would have an advantage to that. Would  
15 that, in your mind, have been the case, or not been the  
16 case?

17 MR. BARRONS: It's not my experience. We were  
18 actually awarded the first two SBIR grants that we ever



19 applied for. So I don't see that that was an issue.

20 Our company also applied for DARPA grants, and  
21 were actually awarded the very first DARPA grants we  
22 ever applied for. So I don't see a direct correlation  
23 of that. The only thing that I could see would be that  
24 a VC-backed company would have been in business long  
25 enough to have developed science to an extent that NIH

109

1 would want to fund it.

2 MR. KLEIN: Okay. Thank you.

3 Dawn Applegate? Pete Varma?

4 MR. VARMA: Thank you for giving me an opportunity  
5 to speak on behalf of small business. When last night I  
6 was preparing it, I had about five pages, but I was able  
7 to bring it down to one.

8 MR. KLEIN: Not an easy task, I'm sure.

9 MR. VARMA: I heard some really good remarks and  
10 suggestions on size standard. My name is Pete Varma and  
11 I'm president of Intraline. We are a industrial supply  
12 wholesale distributor business. We primarily compete  
13 with businesses that are in electrical supplies,  
14 industrial products, fixtures and those sorts.

15 And I am also here on behalf of NCSD. I'm on  
16 the board for Northern California Supply and Development  
17 Council, and also the NDIC chair for Minority Business  
18 Input Committees.

19 We employ ten. We have been in the business  
20 for 15 years. I'm here today as a business owner, and  
21 opposed to letting big business in contracts that should  
22 be going to a small business, and opposed to the  
23 proposal that would let big business continue receiving  
24 contracts that should be going to small businesses.

25                   And I put together some recommendations that  
1 will help. I understand that the SBA is moving in some<sup>110</sup>  
2 right directions. I was fortunate enough to attend the  
3 SBA matchmaking event. Events like that will help  
4 stimulate a lot of small business, the one-on-one  
5 management types of events.  
6                   Our proposed solution to the size standard  
7 issue is incorporated in the five ten five form order.  
8 And it's simple as follows: Identify five top  
9 corporations in any industry, take the total gross  
10 revenue, public or private sector, and determine the  
11 average revenue of those corporations over the last five  
12 years.  
13                   Take 10 percent of the average revenue, and it  
14 becomes a top level of a tier five small business  
15 structure; 20 percent tiered level with the largest  
16 firms; and 10 percent average of the largest  
17 corporations identified. For Small Business  
18 Administration to serve and support. And associated  
19 with tiers, employee size standard following threshold.  
20                   This one here, a couple of different  
21 discussions, but hearing some of the recommendations in  
22 the size matters, you could be a company with one  
23 individual or two employees, or it could be emerging  
24 companies coming in joining the program, or it could be  
25 companies that are now ready to compete with large  
1 companies, like Bechtel, and needs to get to the next<sup>111</sup>  
2 level.  
3                   There's got to be some threshold for those,  
4 too. It's not just the how do they get to the next  
5 level and if there's no support from the SBA side, they

6 need to move on, and that way the -- you know, it's  
7 almost recycling, bring the new small business in,  
8 graduate and take them up to the next level.

9           The threshold that our community came up with  
10 is 1,500, 1,000, 500, 300 or 150. And that could be  
11 tiered down even to a lower level.

12           Now, the question was raised, well, how do you  
13 measure it? How do you track all that stuff? I think  
14 with today's technology, and I think our government is  
15 very sophisticated in using technology in tracking and  
16 providing those types of information. And in my  
17 opinion, I think this will help solutions for the size  
18 standard and small business growth.

19           Thank you.

20           MR. KLEIN: Under the tier system, do you envision  
21 separate set asides in each of those groups? Is that  
22 what you're thinking?

23           MR. VARMA: Yeah.

24           MR. KLEIN: I don't think it's a bad idea, but my  
25 concern is SBA has control over the size standards

1 themselves. We don't have control over the SBIR  
2 process. How would we get buy in or approval from  
3 procuring agencies?

4           MR. VARMA: I think if you take a company that's  
5 revenue at 5 million and has probably ten employees, it  
6 would be difficult for them to grow to the next level  
7 and compete for a \$10 million contract. The scale of  
8 economies. They don't have the infrastructure, finance.  
9 They may have to joint venture or other things.

10           what is happening is so much of the contract  
11 bundling is taking place and the contracts are getting

12 bigger and bigger and bigger, and small businesses are  
13 not going to be able to compete for these large  
14 contracts.

15           And I think the contract -- somewhere, I know  
16 the key cards being used by the federal government, red  
17 cards, or they're programs that are under \$25,000  
18 program that small business can compete for like at  
19 price level.

20           So I think some of those are already in place,  
21 but I think we have to look at it -- other business  
22 areas where small business sizewise taking into  
23 consideration in a two-person operation, under 25,  
24 revenue that could fit in that level, not necessarily  
25 competing for this huge -- because you've got to grow

1 yourself to that level. You can't just leap from a 113  
2 one-million-dollar company to be a  
3 hundred-million-dollar company the next day. It  
4 wouldn't work that way.

5           MR. JACKSON: Yeah, I understand that part of it.  
6 If I'm the procuring agency, and I can get credit, small  
7 business credit, by giving a contract for a large or  
8 small business, why would I want to redistribute the  
9 competition to smaller business? I'm just throwing that  
10 out there.

11           How do you get a procuring agency buy in to  
12 restrict certain of your tiered contracts to just very  
13 small businesses, medium size, small, small business?  
14 How do you get the buy in for procuring agencies to do  
15 that?

16           MR. VARMA: You know, it's always been a tight one,  
17 not just the -- any human part of the business.

18           How do you transform them to open up and maybe  
19 there's some, you know, some kind of a rewards or laws  
20 written in there that requires them to break some of the  
21 contracts for the small businesses in our tiered level.  
22 That gives them the opportunity to compete.

23           Because without that, most of the major  
24 contracts that I see out there -- I don't even bid on a  
25 lot of the government contracts personally, because they

1 are too big. And I'm a small fish. And so how do I <sup>114</sup>  
2 participate? What do I need to do? Do I partner with  
3 somebody else?

4           well, that takes time, resource, finance.  
5 It's a lot of my time. So I don't go after those types  
6 of opportunity. I go after different opportunities that  
7 I can play in those arena.

8           And I think it helps my business, and I see a  
9 lot of businesses that are about my size in the similar  
10 type of industry or service industries, you know, that  
11 really can't compete for the large businesses at all.

12       MR. KLEIN: Thank you.

13       UNIDENTIFIED SPEAKER: John, could you explain what  
14 SBA is doing with regard to the tiers? I followed your  
15 comments, but I'm not quite sure of the background and  
16 how that relates to micro purchasing, if it does at all.

17       MR. KLEIN: At this point it does not. There's  
18 been (inaudible) across the country. There have been  
19 several representatives coming up saying that they  
20 support some kind of tiered approach where smaller  
21 contracts would be reserved for smaller businesses, et  
22 cetera.

23           But there is no statutory basis for that as we

24 speak. So my concern is getting the buy in from the  
25 procuring agencies. I don't see how we could force them  
1 to do that, honestly. But at this point in time, we 115  
2 understand it. We hear that. We're going to go back to  
3 see what we can get from procuring agents in that  
4 regard, I guess.

5 As you know, the 2500 is one thing. 2500 to a  
6 hundred-thousand dollars is statutorily required for  
7 small business. We certainly wouldn't want to push that  
8 forth again. But there's no requirement anywhere for  
9 tier -- I don't know.

10 MR. JACKSON: Nothing to add.

11 MR. KLEIN: It is a recommendation we've seen  
12 across the country and we understand what they're  
13 saying. In theory, it doesn't sound like a bad idea,  
14 but it's something -- so we need to get more buy in than  
15 just SBA buy in. We need to get procuring agents to buy  
16 in for that whole process to work.

17 UNIDENTIFIED SPEAKER: Or some new legislative  
18 action.

19 MR. THOMPSON: We have gone through the entire  
20 list. I'll go back to the beginning.

21 William Marshall? Sharon Gadberry? Suzanne  
22 Tucker? Jose Zero? Barbara Felt? Dulce Moralis  
23 Subrizi? Martha Bennett? Dawn Applegate? Troy Hines?  
24 And Cecilia McCloy?

25 MS. MCCLOY: Here.

1 MR. KLEIN: Sorry, I missed you. My fault. 116

2 MS. MCCLOY: I'm just going to jump up and say I  
3 know I'm on that list.

4 MR. KLEIN: Yes, you are.

5 MS. MCCLOY: Great. Hello, my name is Cecilia  
6 McCloy, CEO of Integrated Science Solutions, a  
7 woman-owned science and engineering service firm. Our  
8 corporate office is in Walnut Creek, California, with  
9 five other offices in California and Nevada, Washington,  
10 Utah and Colorado.

11 My company provides science and engineering  
12 support services. Because of the broad nature of our  
13 business, I compete under several size standards,  
14 including 541330, 541620, 562910, 561210 and 541690 as  
15 well as several others. I won't bother going over  
16 those.

17 I'm particularly concerned with the  
18 restructuring of SBA federal size standards and the  
19 effects it will have on small businesses, such as my  
20 own. Specifically, I would like the SBA to set a  
21 standard head count of a hundred full-time employees for  
22 most service size standards. This would help me to  
23 streamline my bid process with government contracts, and  
24 allow businesses to compete in many service lines where  
25 they have something to offer, thus increasing small

1 business participation.

117

2 98 percent of all U.S. firms have less than a  
3 hundred employees, and 89 percent have less than 20.  
4 SBA should foster growth in small businesses looking to  
5 grow beyond 100 employees. So some standards may need  
6 to be maintained at the 500-employee level. I don't  
7 have an opinion on the number of levels of small  
8 business standards.

9 Also, current law has established a 23 percent

10 small business goal on the total value of all prime and  
11 subcontracts. The Small Business Act calls for a fair  
12 portion of all these federal contracts, subcontracts, be  
13 awarded to small businesses. With 98 percent of all  
14 U.S. firms having less than a hundred employees,  
15 23 percent does not seem to qualify as a fair portion.

16 I am also anxiously awaiting SBA's woman-owned  
17 set aside program. I am also pleased to testify today  
18 on behalf of Women Impacting Public Policy, a national  
19 bipartisan public policy organization representing more  
20 than 500,000 women in business and women business owners  
21 nationwide.

22 WIPP understands SBA's desire to improve the  
23 small business size regulations, and shares SBA's  
24 desired goal, which is simplification and clarity with  
25 regard to what constitutes a small business.

1 After all, no small business wants to find out<sup>118</sup>  
2 they have been competing against large businesses that  
3 just happened to figure out a way to gain the federal  
4 contracting system.

5 Simplification of federal regulation is always  
6 beneficial to small businesses. Withhold its membership  
7 and work with the procurement committee to respond to  
8 the proposed size standards and here's what we found.

9 First, we understand that SBA is considering  
10 reducing its size standards to ten levels. WIPP does  
11 not agree the number of size standard levels should be  
12 reduced simply for the sake of reduction.

13 Rather, SBA should establish as many size  
14 standard levels as necessary to reflect the specific  
15 characteristics of sectors and subsectors of our



16 economy.

17           Moreover, WIPP members have found SBA's use of  
18 the NAICS system and its detailed characterization of  
19 industry subsectors to be helpful in determining the  
20 applicable size standard for their businesses.

21           Secondarily, WIPP favors retaining size  
22 standards based on annual receipts -- I would disagree  
23 with that, but I'm doing this for WIPP -- and the SBA  
24 change the definition of receipts from total of gross  
25 income to net.

1           WIPP expresses no opinion as to whether all <sup>119</sup>  
2 small businesses should be subject to annual receipts or  
3 other revenue-based standard. To the extent SBA  
4 continues to include employee-based standards to be  
5 measured, the number of employees as full-time  
6 equivalents, FTE basis, rather than continuing the  
7 current standard which counts each individual employee  
8 on a full-time, part-time, temporary or other basis.

9           One of the keys to success for many women  
10 entrepreneurs is flexibility in employment. WIPP  
11 believes that a rule which counts every employee as a  
12 full-time employee, even though he or she may be working  
13 part time or in job-sharing, would negatively impact on  
14 many employees of small businesses, especially women and  
15 single parents for whom flexible working arrangements  
16 are a necessity rather than a luxury.

17           we also do not believe independent contractors  
18 should be treated as employees of a small business  
19 concern, and payments to them by the small business  
20 should not be treated any differently than the business  
21 expenses in determining net income.

22           We encourage the SBA to continue to promote  
23 joint venture agreements between small business  
24 contractors. Such agreements are important for small  
25 businesses to be able to compete fairly for government

1 contracts, especially given the variance to access and<sup>120</sup>  
2 the contract bundling environment, which people have  
3 spoken about today.

4           WIPP requests that SBA identify limitations on  
5 small business joint ventures except when necessary to  
6 guard against fraud or abuse.

7           In closing, we ask the SBA to resist the  
8 temptation to change for change sake. Federal  
9 contracting is far more complex and has many more  
10 barriers for women-owned businesses in the commercial  
11 market. Making drastic changes to the size standards  
12 will complicate federal procurement even further.

13           We agree that all federal contracting officers  
14 should have a clear set of guidelines to avoid the  
15 mistake of using a large business as a small business.  
16 We believe the effect on small businesses should be the  
17 number one concern of the SBA.

18           Thank you.

19           MR. KLEIN: In the beginning of your testimony,  
20 before you did the WIPP part, you had said that you  
21 support a hundred full-time employees, is what you said.  
22 Did you mean full-time equivalent or full-time  
23 employees?

24           MS. MCCLOY: FTEs, just to simplify that area,  
25 yeah.

1           MR. KLEIN: Okay.

2           MR. JACKSON: Just to clarify that, also the

3 hundred employees that you recommend, that would be in  
4 the industries you operate, or are you looking across  
5 the board?

6 MS. MCCLOY: In the service sector primarily, yeah.

7 MR. JACKSON: There's a lot of industries who  
8 currently have size standards based on average annual  
9 receipts. That would include companies that have many  
10 more than a hundred employees, such as the IT area at  
11 \$21 million in revenues. At that level a company can  
12 have anywhere from 125 employees, low end, to as high as  
13 250 to 300 employees at a higher end.

14 One of the concerns with our March 2004  
15 proposal was taking away small business eligibility, and  
16 many commenters suggested a grandfathering provision.

17 If SBA took a single standard for procurement  
18 for services, do you think there should be consideration  
19 for a time period for companies to adjust, like in the  
20 IT area that, again, companies would be well over the  
21 hundred employee mark?

22 MS. MCCLOY: Personally, I would prefer a  
23 grandfathering clause for, say, two to three years.  
24 However, I also mentioned in my testimony that there may  
25 be some other industries where you might want to

1 increase the hundred-employee level. 122

2 I'm trying to remember in my rockets group  
3 we -- we're only a 55-person firm, but we do work across  
4 all these things, and it drives me crazy. But in our  
5 rockets group, I believe like a small business is  
6 considered employees with a thousand or less. So, you  
7 know, I think that's the biggest small business  
8 designation there is.

9           Yeah, if there's some way we could simplify  
10 these things, because we get requests from people who  
11 say, well, last week when we put out that procurement  
12 you guys were a small business. This week we're putting  
13 out this procurement and you aren't a small business.  
14 What's going on here? We're like, it's not our fault.

15           MR. JACKSON: Do you see the contracts that  
16 different? Are the contracts that different where for  
17 one --

18           MS. MCCLOY: Because we are doing science and  
19 engineering, I could be asked to design a level three  
20 containment field for Dugway Proving Grounds for  
21 chemicals, and then I am not a small business.

22           I could be asked to be doing environmental  
23 consulting services, and then I'm precluded because I'm  
24 too big. And I'm not design -- all of a sudden  
25 designated a large business.

1           MR. JACKSON: Are your competitors in a similar 123  
2 situation, or are you in a unique situation?

3           MS. MCCLOY: I would say the people who are doing  
4 science and engineering, yeah, we are all stuck sort of  
5 in the same boat.

6           MR. JACKSON: Thank you.

7           MR. KLEIN: Juan Santana?

8           At this point we have come to the end of your  
9 scheduled hearing for the morning. Is there anyone here  
10 who is here for the afternoon, who would like to testify  
11 now? Anyone else who would like to testify?

12           MS. GARCIA: Someone who has not registered?

13           MR. KLEIN: Surely.

14           MS. GARCIA: Yes.

15 MR. KLEIN: When you get to the front, spell your  
16 name and the firm name as well.

17 MS. GARCIA: My name is Cheryl Garcia, C-h-e-r-y-l  
18 G-a-r-c-i-a. I'm secretary-treasurer of the B&C  
19 Janitorial Service. We're an 8(a) HUB Zone  
20 veteran-owned firm.

21 I first want to thank you very much for  
22 allowing me this opportunity. I apologize for not  
23 registering to testify ahead of time.

24 I just have a few comments, having listened to  
25 some of the comments that were made today and reviewing

1 the proposed change in the regulation. 124

2 For my industry, I actually had to prepare a  
3 report recently for SBA, for my business, and it was  
4 extremely time-consuming and cumbersome to gather the  
5 information about my FTEs.

6 In that regard, I would like to say that for  
7 my personal company and, perhaps, for my industry, using  
8 revenue-based size standards makes a lot more sense for  
9 us. That data is readily available; it's verifiable  
10 through IRS. We have to file tax returns that are, you  
11 know, again readily accessible. And I think it just  
12 makes a lot more sense for us.

13 Also, I would like to recommend that there be  
14 a very clear definition about what is an employee.  
15 Part-time is not full-time. Full-time may not be an  
16 FTE. And so I strongly recommend that there be a very  
17 clear definition of what is a full-time employee. And  
18 if that's FTEs, then please make that very clear.

19 MR. KLEIN: Do you support FDEs versus a different  
20 measure?

21 MS. GARCIA: I support revenue based, but if you're  
22 not going to use revenue base, then absolutely FTE.

23 Because in my industry, I have 40 employees.  
24 we do joint venturing. We are in the mentoring  
25 publishing program, and the majority of our employees

1 are not full-time. So this is a very sensitive issue <sup>125</sup>  
2 for us, if we have to count every part-time employees as  
3 a full-time.

4 I also strongly recommend annual  
5 recertification. Again, if you're using revenue-based  
6 data, that's certainly very easy.

7 When we have to do our an annual update --

8 MR. KLEIN: What do you mean by that, annual  
9 recertification, in terms of?

10 MS. GARCIA: Of your size.

11 MR. KLEIN: For the contracts you already have, you  
12 want to just recertify the contracts you already have?  
13 You do have to recertify before every contract you go  
14 after today. So ones you received in the past, you want  
15 to recertify them in order to keep them?

16 MS. GARCIA: No, not necessarily. I think that if  
17 you're awarded -- the majority of our contracts, our  
18 federal contracts, are base year and four option years.

19 I think if you -- a company should be allowed  
20 to complete their option years, but at the end of that  
21 time, you know -- and at the time of award of any new  
22 contract, they should be required to recertify. And in  
23 the annual update, if you're an 8(a) firm, in the annual  
24 update, the information is right there.

25 MR. KLEIN: So firms that have grown to be other

1 than small during their one plus four option years, you  
2 would continue to count them as small or not, do you  
3 think?

4 MS. GARCIA: Well, for me, personally, I think it's  
5 fine. I think if you're performing successfully on a  
6 contract and you have the option years available to you,  
7 I guess that is reasonable to allow a firm to continue  
8 their option years.

9 My concern is with some of these contracts, of  
10 which we are not privy, but where they are 20 years in  
11 length. I think that that needs to be looked at as a  
12 totally separate issue. But in the janitorial industry,  
13 a base year with four option years, five-year period, is  
14 not unreasonable.

15 The last thing I would like to say is that I  
16 would like to very much suggest that these large  
17 businesses that are getting small business contracts be  
18 prosecuted.

19 It's very clearly against the law. And I'm  
20 not -- I don't understand why the SBA would want to, for  
21 my industry, fix something that's not broken when, in  
22 fact, there's a huge problem with violators.

23 MR. KLEIN: What problem do you see?

24 MS. GARCIA: Well, large businesses getting small  
25 business contracts. They have exceeded the size

1 standard and they are getting small business contracts. <sup>127</sup>

2 MR. KLEIN: They are getting set aside contracts?  
3 Our understanding is the problem is not large businesses  
4 getting contracts. We can all agree that that's wrong.

5 what's been going on, and we are considering,  
6 is what to do with firms who have grown to be other than

7 small or firms who have been acquired or merged with  
8 large businesses. That's really the issue, I suppose,  
9 to large business getting contracts.

10 But we don't know of cases where large  
11 businesses actually certify themselves to be other than  
12 small, and then receive contracts as a small business.

13 MS. GARCIA: No, the problem is exactly as you  
14 mentioned. These are large businesses that are  
15 certifying themselves as being small.

16 MR. KLEIN: Large businesses are certifying  
17 themselves to be small?

18 MS. GARCIA: They are stating that they are small.  
19 They are registered in CCR, and they are large, and  
20 everybody knows they are large.

21 MR. KLEIN: Well, I mean, the process as it  
22 currently stands should correct that.

23 There is a protest mechanism where any firm  
24 who is interested for a particular procurement could  
25 protest the size of the apparent success grantor. For

1 instance, if large business X won the contract for 128  
2 (inaudible) any firms who submitted an offer on that  
3 procurement could protest the size to the contracting  
4 officer. And if, in fact, the firm was other than  
5 small, that firm would be ineligible to be awarded the  
6 contract. But the process as it currently stands should  
7 correct that situation.

8 MS. GARCIA: Yes, I agree. Should, yes. That is  
9 what I hope, that it will continue to do so. That's  
10 all.

11 Any questions?

12 MR. PACCIONE: I would just mention that on the



13 business of the CCR, you're quite correct. We work with  
14 the marketplace on all these size processes, so things  
15 happen. In fact, whenever we see or get information  
16 that somebody is registered in what we call as an  
17 acronym, CCR, we will investigate. We can institute a  
18 size determination.

19 So, you know, again, we -- what I would also  
20 emphasize is that any negative information, anything  
21 about somebody who is a large business other than small,  
22 using those terms, that information has to go to the  
23 SBA, whether it's this office or anywhere in the  
24 country. And if it's -- I don't want to say legitimate,  
25 if it has a basis and is not frivolous, we will do our

129

1 best to check into it.

2 But I know things fall through the cracks and  
3 that's what you are talking about. And we hear you, and  
4 we will continue to try harder to find any cases where  
5 companies are saying that they are small and, in fact,  
6 they may not be.

7 MS. GARCIA: Thank you.

8 MR. KLEIN: Even in the past year, Gary's office  
9 has gone through CCR and tried to weed out firms that  
10 have, in fact, been other than small.

11 MR. JACKSON: We have worked with the General  
12 Services Integrated Acquisitions Group that's in charge  
13 of CCR. We just instituted automated checks of small  
14 business status.

15 We have our procedures that if you are aware  
16 of a company on CCR that's saying it's small and it's  
17 not, provide that information to my office and we will  
18 conduct a review. We've had excellent cooperation with

19 businesses.

20           It's amazing, sometimes. Companies putting in  
21 their phone numbers on CCR, instead of annual receipts.  
22 (Inaudible) businesses division size instead of their  
23 affiliates. And we've been trying to address that in a  
24 number of ways. It's not foolproof, but we've done a  
25 lot of work.

1           I wanted to reiterate, and I think I mentioned<sup>130</sup>  
2 this earlier, that many of the studies that we've seen  
3 on large businesses having small business awards is more  
4 of a reporting problem. There are some cases that it's  
5 not.

6           The vast majority of the cases and the studies  
7 consistently point to the policy of a long-term  
8 contract, a company small at the time it gets the  
9 contract, during the course of the contract it's bought  
10 out by a large company or grows to be small, yet we  
11 continue to score that as a small business award.

12           We agree we're concerned about that, because  
13 it has an effect on goaling. And we've caused some  
14 changes that address some of that issue, but we also  
15 have proposed an annual recertification that we are  
16 about to finalize. I can't say the details, if we'll  
17 adopt what we propose as an annual recertification. We  
18 got over 600 comments. Final action on that issue is  
19 hopefully going to be published later this year.

20           In the case of fraudulent businesses,  
21 fortunately, again, the studies that have been done  
22 don't show fraud as the major reason for what's been  
23 reported. That's the good news. The bad news is it's  
24 tough to prosecute fraud.

25                   My recommendation to you and any other small  
131  
1 businesses, if you're competing on a contract,  
2 especially those set aside for small business, that you  
3 feel a competitor is not small, challenge it. There are  
4 certain procedures that we do have to follow, but we can  
5 take most of those cases, and they do result in us  
6 making sure a large business doesn't receive an award  
7 improperly.  
8                   So if you see those situations, bring those to  
9 our attention, because we're just as concerned as you  
10 are.  
11           MS. GARCIA: Okay. Very good. Thank you.  
12           MR. JACKSON: Thank you.  
13           MR. KLEIN: Okay. That concludes us this morning.  
14 we will be back here at 1:30. Thank you.

15                   (Noon recess.)

16  
17  
18  
19  
20  
21  
22  
23  
24  
25

1                   TUESDAY, JUNE 28, 2005; 12:00 P.M.                   132

2  
3           MR. QUINN: For those of you who were not here this  
4 morning, I'm Mark Quinn, district director of the  
5 San Francisco SBA office. For those of you who are here

6 just this afternoon, I'd like to introduce the members  
7 of the panel.

8 Gary Jackson from SBA Size Standards in  
9 Washington. John Klein from the Office of General  
10 Counsel in Washington. And Bob Paccione from the Office  
11 of Government Contracting here in San Francisco.

12 This morning I gave my theory on size  
13 standards for small business being that if you're a  
14 small business, you ought to be able to, in a pinch,  
15 take your dog to work.

16 No one suggested that should be what the size  
17 standard should be changed to, so my alternative size  
18 standard would be that you know you're a small business  
19 if, in a pinch, you have a computer problem, you have to  
20 call someone out of homeroom to fix it. So if any of  
21 you want to use that as the basis for a size standard  
22 definition, feel free to use that and claim it as yours.

23 With that, let me turn it over to John Klein,  
24 who is going to moderate the session this afternoon.  
25 Thanks.

1 MR. KLEIN: Thank you. Again, we'll go forward <sup>133</sup>  
2 with the size standard hearing as we did this morning.  
3 For those of you who were not here this morning, let me  
4 go over the rules again.

5 Your testimony will be recorded by a certified  
6 court reporter. When you get to the podium, please  
7 state your name and spell it and the company or  
8 organization that you are with, for the record.

9 Names will be called in the order that we have  
10 them listed on the registration form, and each person  
11 will be limited to five minutes.

12           when you finish the presentation, please  
13 supply us with any copies of materials you would like us  
14 to have, and we can put it into the record as well.

15           we will ask questions here and there as that  
16 becomes appropriate, and we'll just go forward.

17           Okay. The first person this afternoon, Jo-Ann  
18 Butler? Mike Stewart? Gail Maderis?

19           Come up to the podium and please state and  
20 spell your name for the record. Thank you.

21           MS. MADERIS: Good afternoon. My name is Gail  
22 Maderis, G-a-i-l M-a-d-e-r-i-s. I'm president and CEO  
23 of Five Prime Therapeutics, Incorporated, and I also sit  
24 on the board of BayBio and on the Mayor's Biotechnology  
25 Advisory Council for the City of San Francisco.

1           On behalf of Five Prime and BayBio, I would<sup>134</sup>  
2 like to thank the SBA and the members of the hearing  
3 panel for holding this public hearing in San Francisco  
4 and for allowing me the opportunity to comment on the  
5 future of SBA size standards.

6           The Bay Area is home to many innovative small  
7 venture-backed companies. In fact, 60 percent of the  
8 820 life science companies in the Bay Area are small,  
9 having less than 50 employees.

10           My comments today will focus on an issue that  
11 directly affects my company, as well as many other small  
12 biotech companies. That is, the obstacles to  
13 participation in the Small Business Innovative Research  
14 program, the SBIR, by businesses that are majority owned  
15 by venture capital companies, VCCs.

16           Small biotechnology companies rely on SBIR for  
17 grants to fund cutting-edge, early-stage research in

18 areas where venture capital and other sources of  
19 financing are difficult to obtain.

20           However, to be eligible for an SBIR award, a  
21 business concern must be at least 51 percent owned and  
22 controlled by individuals who are citizens of the United  
23 States. SBA's Office of Hearing and Appeals has  
24 interpreted the term "individuals" to mean human beings.  
25 This interpretation excludes corporations, including

135

1 venture capital companies.

2           Notably, there is no statutory requirement  
3 that compels this interpretation, nor is there a  
4 definition of the term "individual" in the law  
5 establishing the SBIR program.

6           As a result, many small businesses in the  
7 biotechnology sector cannot participate in the SBIR  
8 program because one or more of their owners or investors  
9 is a corporate entity or a VCC. The unnecessary  
10 exclusion of these small businesses is not consistent  
11 with the purpose of the SBIR program, which is to  
12 stimulate small businesses that will commercialize  
13 important technological development.

14           I would like to provide a specific example of  
15 how this interpretation of the small business definition  
16 is impacting our company.

17           Five Prime Therapeutics is a privately-held  
18 biotech company focused on the discovery and development  
19 of novel biologic therapy. Our company has 62  
20 employees, and has raised \$85 million in private equity  
21 from leading investor groups. Approximately 15 percent  
22 of Five Prime's equity is owned by employees; 75 percent  
23 is owned by ten venture capital companies, with the

24 largest VCs owning less than 11 percent each; and  
25 10 percent is owned by corporations.

1                   Five Prime has developed a suite of innovative<sup>136</sup>  
2 proprietary technologies to industrialize biologic  
3 discovery, enabling us to identify protein and antibody  
4 therapeutics with unprecedented efficiency and success.

5                   One of Five Prime's key assets is the world's  
6 largest and most comprehensive collection of human  
7 full-length cDNAs.

8                   In July 2004, Five Prime submitted an SBIR  
9 grant proposal to screen our proprietary collection of  
10 cDNAs to identify novel protein therapeutics to treat  
11 diabetes.

12                   As you may know, diabetes is a growing  
13 national health crisis in the U.S. Approximately  
14 150 million diabetics were identified in the world  
15 Health Organization 2002 survey, and the WHO predicts  
16 this population could double by 2025.

17                   Only 20 percent of type II diabetic patients  
18 are managed effectively with current therapy. In  
19 May 2005, Five Prime received a positive response from  
20 the National Institute of Diabetes and Digestive and  
21 Kidney Diseases, the NIDDK, based on the scientific  
22 merits of our proposal. At that time, we were asked to  
23 submit verification forms.

24                   Two weeks ago the NIDDK notified us that they  
25 are concerned whether we are eligible to be funded as a

1 small business. It is unfortunate that the SBA small<sup>137</sup>  
2 business definition may prevent us from proceeding with  
3 this innovative research that could result in new

4 treatment for hundreds of millions of patients afflicted  
5 with type II diabetes.

6 Five Prime has many similar innovative  
7 discovery projects which we cannot pursue within the  
8 limitations of our venture funding. SBIR represents an  
9 important source of funding to enable us to pursue this  
10 innovative research.

11 However, until the SBA small business  
12 definition is modified, Five Prime will not submit  
13 additional SBIR grant proposals. We have investigated  
14 other granting agencies, such as DARPA, to fund  
15 applications through our drug discovery program to  
16 military and bioterrorism projects. But DARPA, as well,  
17 encourages companies of our size to apply through the  
18 SBIR grant mechanism.

19 We recommend that SBA adopt a rule that  
20 addresses the actual ownership structure of small  
21 biotech companies that are owned and controlled by VCCs.  
22 Specifically, we suggest that the size requirements be  
23 revised to permit VCC ownership of SBIR applicants to  
24 count towards the 51 percent U.S. ownership and control  
25 requirement.

1 This would allow greater participation in the <sup>138</sup>  
2 SBIR program by small biotech companies, but would not  
3 permit participation by venture firms that are  
4 affiliated with large companies.

5 If these proposed changes were enacted, small  
6 businesses with ownership structures similar to Five  
7 Prime would be able to take advantage of this important  
8 program and participate in research efforts that are  
9 critical to our nation's safety, health and security.



10 Thank you.

11 MR. KLEIN: A few questions.

12 MS. MADERIS: Yes, questions.

13 MR. KLEIN: Your company, you said 75 percent is  
14 owned by venture capital companies?

15 MS. MADERIS: Venture capital companies.

16 MR. KLEIN: And who is the largest single  
17 shareholder of the company? Is it one individual or is  
18 it spread out as well?

19 MS. MADERIS: No, individual ownership is spread  
20 out among -- we have a stock purchase plan, so all of  
21 our employees own stock, as well as the founders of the  
22 company. And then we have ten venture capital groups,  
23 and they are relatively equal size. So the largest VC  
24 company owns less than 11 percent.

25 MR. KLEIN: Under SBA's normal affiliation rules,  
1 aside from the venture capital issue, we deemed the 139  
2 individual or the company that owns the greatest  
3 percentage of the stock to control it. So in your  
4 situation, if there are two or three companies or  
5 individuals who own similar outstanding blocks, each of  
6 those would be deemed to control?

7 MS. MADERIS: Yes. So there would be six. So we  
8 have six equal-sized investors --

9 MR. KLEIN: Okay.

10 MS. MADERIS: -- among those ten. So we would have  
11 six equal owners at the highest level, and then we would  
12 have others below that.

13 MR. KLEIN: And those six, are they individually  
14 small, in your mind, other than the ownership by --

15 MS. MADERIS: They're some of the premier life

16 science venture capital companies in the U.S. So  
17 they're groups like Domain, Kleiner Perkins Group,  
18 Advanced Technology Ventures, ATV. There's a Texas  
19 Pacific Group. They are all venture companies. Most of  
20 them are focused specifically on investments in life  
21 science.

22           Some of them also have high-tech arms to them.  
23 But their sole purpose for being is to fund innovative  
24 research. They're not corporate entities. They take  
25 money from private individuals, high net-worth

1 individuals, and then invest that money in startup  
2 companies.

140

3           MR. JACKSON: You had mentioned in your testimony  
4 that SBA should look at the VCs that invest in your  
5 company as part of the individual ownership. I'm a  
6 little unclear what you mean by that, if you are  
7 suggesting an exemption from looking at ownership by  
8 excluding the ownership of the VCs, or looking at VCs in  
9 a different way?

10           MS. MADERIS: I would look at VCs as individuals,  
11 as falling -- as part of the 51 percent U.S. individual  
12 ownership. Because I think that the change in the  
13 definition of smallbusiness under SBA was designed to  
14 exclude companies that were setting up small firms and  
15 then owning the majority, controlling those firms as a  
16 loophole or -- excuse me, as an opportunity to acquire  
17 funding.

18           The reality is, it costs 800 million to  
19 \$1.3 billion to take a drug to market. The public  
20 markets will not fund early-stage research, so the vast  
21 majority of small biotech companies are venture funded.

22 That's their main source of capital.

23 And so by excluding -- and, in fact, the best  
24 of the innovative research are the ones that are funded  
25 by the venture community. So by excluding that, you are  
1 actually excluding the most innovative, if you will, of<sup>141</sup>  
2 the biotech companies.

3 MR. KLEIN: The VCCs that own your company, are  
4 they, in turn, owned by other VCCs, or are they owned by  
5 individuals? How does that work?

6 MS. MADERIS: It varies. Many of them have limited  
7 partners that invest, and then they are owned by  
8 individuals.

9 MR. KLEIN: Because we just had a rule that came  
10 out very recently which said if the company owns you  
11 51 percent, whatever they can own, but if the company  
12 itself is owned 51 percent by individuals, then that's  
13 okay.

14 So in your case, if you had a fund that was  
15 owned 51 percent by individuals, that would count  
16 towards the ownership.

17 MS. MADERIS: The challenge is to backtrack on  
18 that.

19 MR. KLEIN: Right.

20 MS. MADERIS: The venture funds raise capital from  
21 limited partners who are, in turn -- they may be pension  
22 funds for the State of California or other entities.  
23 They could be individuals.

24 So to try and track that back, you know,  
25 eventually, yes, it is for the benefit of individuals,

1 but it may be a lengthy process to track back to that.<sup>142</sup>

2 And I'm not sure that the SBA guidelines allow us to do

3 that, to work backwards.

4 MR. KLEIN: I'll ask you a question I asked others  
5 this morning. We have heard from other people in these  
6 hearings that firms who are VCC-backed are able to go  
7 after more opportunities than firms who are not,  
8 therefore, giving them greater competitive edge than  
9 other firms who don't have that luxury. Is that  
10 something that you see happening or not happening?

11 MS. MADERIS: I believe that that's true. When we  
12 look at -- whether it's in licensing a product from a  
13 pharmaceutical company or from an academic institute or  
14 an individual inventor, one of the big questions is, do  
15 we have the capital to take that forward and  
16 commercialize it?

17 And so I do believe that venture funding is  
18 key. It's also absolutely critical to attract and  
19 retain the brightest scientists, which is what we need  
20 for our research, because they are interested in where  
21 their paycheck is coming from, and venture backing is --  
22 is our main source of income.

23 MR. KLEIN: Thank you.

24 MR. QUINN: Could I ask, because you've asked that  
25 question twice, it's my understanding what you're asking

1 is do they have an unfair competitive advantage if they<sup>143</sup>  
2 are a venture capital-backed firm?

3 But, in fact, what you are really asking is  
4 are the ones who have greater capitalization, are they  
5 better able to pursue more SBIR opportunities, and  
6 regardless of whether they are VC funded or they have  
7 funding in any other way?

8 So it's not a function of who is the investor

9 and where their source of capital is from, it's the fact  
10 that they are better capitalized that allow them to  
11 compete and pursue other and better opportunities. So  
12 it's not who the money comes from; it's how much they  
13 have.

14 So it's not as though it's a competitive  
15 advantage unfairly. It's really a case of who has the  
16 backing to be able to pursue more opportunities.

17 MS. MADERIS: If I may make the comment to give you  
18 a sense, one of our founding technologies we licensed in  
19 from Japan. And that technology for full-length human  
20 cDNAs was actually developed based on a \$60 million  
21 investment by the Japanese government.

22 It was then turned from an academic institute  
23 in Japan that couldn't commercialize it to a small  
24 biotech company in Japan that also didn't have the  
25 resources to fully exploit technology. They, in turn,

1 licensed all human applications of the technology to us,<sup>144</sup>  
2 based on the fact that we were able to raise venture  
3 capital to support a large-scale research effort. All  
4 of that transfer would not have been possible but for  
5 being a well-financed venture company.

6 Now we want to take this tremendous technology  
7 that we have and turn it into medicines to treat a wide  
8 variety of diseases, but we can't do all of that on  
9 venture backing.

10 And the NIH is interested in working with us  
11 in this, but without the SBIR grant mechanism, it's  
12 limited in terms of how much we can do.

13 I think the U.S. is losing competitive  
14 advantage by not changing these rules.

15 MR. KLEIN: Thank you.

16 Richard Ventura? Connie D'Aura? Rosa  
17 Phillips?

18 MS. PHILLIPS: My name is Rosa Phillips, and I'm  
19 the president of Phillips & Associates, dba Express  
20 Personnel Services. Rosa is R-o-s-a P-h-i-l-l-i-p-s.

21 Thank you for your time and the opportunity to  
22 address this hearing panel as a small business owner.  
23 As I mentioned, my name is Rosa Phillips, and I'm in the  
24 staffing industry. My company provides workers to  
25 companies throughout Solano and Napa County.

1 In 1986, when my husband and I decided to go<sup>145</sup>  
2 into business for ourselves, we made the decision to be  
3 part of a franchise organization. We purchased the  
4 rights to Express Services, Inc., a franchise located in  
5 Oklahoma City.

6 We liked the concept of a turnkey, and saw the  
7 benefits of having a back office support group that  
8 would be able to do the marketing as well as the billing  
9 and also the technology research, among several other  
10 functions of business. The fact that we could contract  
11 all of these services into one resource, the franchisor,  
12 was convenient and cost-effective for us.

13 It concerns me that being part of a franchise  
14 organization, the SBA views the franchisor and my  
15 company as one entity. This is not correct.

16 My business is separate and distinct from the  
17 franchisor, Express Services, Inc. The franchisor has  
18 no responsibility for my day-to-day business operation.  
19 My business was incorporated in 1991, and now is a  
20 women's minority business entity certified through the

21 supplier clearinghouse here in San Francisco.

22 I have my own state and federal I.D. number,  
23 as well as my workers' comp and my unemployment, state  
24 unemployment account. I hire my own attorneys,  
25 accountants, insurance brokers, to assist me with my

1 business and advise me in business-related issues.

146

2 I provide fringe benefits for my staff,  
3 including medical, dental, vacation, holiday, PTO, and a  
4 pension plan, and I maintain a company handbook, which  
5 outlines their staff duties and the company policies.

6 My company pays the state, federal, local  
7 taxes, and I'm basically responsible for covering the  
8 overhead and all operational costs, and securing and  
9 repaying any of the business loans that I have had in  
10 the past.

11 I have the sole responsibility for recruiting,  
12 screening, hiring, disciplining, terminating and  
13 training of the temporary workers that we put out in the  
14 workforce. I assign them to the respective clients.

15 Please note that the respective roles of the  
16 franchisor and my business distinguish us from other  
17 franchise businesses. Here are some of the examples.

18 As an independent franchise owner, I have the  
19 sole responsibility for the credit collection process  
20 should a client fail to pay an invoice. My business  
21 bears the financial risk.

22 Because we are in the people business and not  
23 an over-the-counter product business, my business  
24 contracts with the franchise -- through the franchise  
25 agreement with Express Services, in order for them to

147

1 perform the administrative responsibilities of receiving  
2 the accounts receivable. And, there again, my business  
3 receives a percentage of the invoices provided in this  
4 franchise agreement.

5 Under the franchise agreement, the franchisor  
6 assumes responsibility for processing the payroll in  
7 order to ensure the proper withholding payments,  
8 government forms going in to pay the taxes.

9 Although the franchisor processes the payroll  
10 checks for my business, I am responsible for actually  
11 issuing the checks to the associates or the temporary  
12 employees.

13 In order to ensure the compliance with  
14 applicable rules and regulations, the franchise serves  
15 as the employer of record for the federal withholding  
16 purposes of the temporary workers of which I hire and  
17 place on a day-to-day basis.

18 All the day-to-day activities with respect to  
19 the employment of the temporary workers are conducted  
20 under my direction.

21 As I stated previously, the concern for  
22 viewing the franchisor and franchisee as one entity is  
23 not accurate.

24 Simply stated, I would like to participate on  
25 a level playing field with other small business owners,

1 and I would like the opportunity to qualify for some of<sup>148</sup>  
2 the government opportunities.

3 The SBA should consider the following factors  
4 when determining small business status. Who bears the  
5 entire risk of the financial loss from business  
6 operations? I do.



7                   who retains the majority of the profits from  
8 its operations? I do.

9                   who maintains the day-to-day control over its  
10 operations? I do.

11                  Is there a common ownership and management  
12 between the franchise owner and the franchisor? Not  
13 really.

14                  Thank you for your time, and do you have any  
15 questions?

16           MR. KLEIN: Thank you.

17                  Franchisees may be eligible as individual  
18 small businesses depending upon the actual franchise  
19 agreement itself. I know, for example, Express  
20 Personnel, there was some concerns that the agreement  
21 itself had too much control on the franchisor.

22                  You mentioned the payroll and payments going  
23 directly to the franchisor. Do you have an option in  
24 that? Could you do it yourself? Could you go to  
25 someone else if you wanted to, or is it required that

1 you go to them and payment made directly to them? 149

2                  It appears that if payment goes to them and  
3 then they give you some sort of commission, is what it  
4 really looks like to us. So is that what's happening in  
5 your mind? Explain that situation for me.

6           MS. PHILLIPS: In my mind is we get a royalty of  
7 the business that we go out and we sell. You know, I'm  
8 the one that is out negotiating the contracts with the  
9 local companies. I negotiate how much they are going to  
10 reimburse me for the people that I have out there.

11                  We, my partner and I, have selected to utilize  
12 Express Services, Inc. as our means of funding for

13 administrative purposes. They handle all the back  
14 office where, you know, when we were making this  
15 evaluation whether we wanted to franchise or not, we  
16 selected to go this route because the headache of having  
17 people, internal staff, more people, to us it focuses us  
18 on what we do best, hiring people, having the  
19 relationship with our client companies.

20           Although, as an owner and a business person,  
21 there is a lot of administrative time that I've had to  
22 take away from what I do best, which is, you know, work  
23 with our companies. So by selecting Express, the  
24 franchisor, it was just a matter of a jump-start. It  
25 was a turnkey operation.

1           If I didn't have Express Services, I'd  
2 probably have another funding company that would handle  
3 all this for us. 150

4           MR. KLEIN: Did you say that the employees are  
5 employees of the franchisor? Did you say that?

6           MS. PHILLIPS: Actually, they are both. They are  
7 the employer of record, but I have the direct one-on-one  
8 with them.

9           All the payroll is processed back in Oklahoma  
10 City, sent to us electronically. We actually cut the  
11 paychecks, and I sign the paychecks within our office.

12          MR. KLEIN: So hypothetically, if a franchisee,  
13 something went wrong financially, they went under, do  
14 the employees go from the franchisor to another  
15 franchisee? What happens to the employees at that point  
16 in time?

17          MS. PHILLIPS: At that point in time, most likely  
18 we would probably have another office come and take

SanFrancisco.txt

19 over. And I've had that happen.  
20 we had a franchisor in -- excuse me, a  
21 franchisee in Berkeley that decided to call it quits.  
22 And because I'm in Vallejo, pretty close to the Berkeley  
23 area, I was able to assist that office and take over  
24 their accounts, and started servicing them. I actually  
25 hired their internal staff onto my staff.

151

1 MR. JACKSON: With that, a number of franchisees  
2 from Express Personnel testify at our hearings, and a  
3 lot of the questioning was talking about the  
4 employer/employee relationship. But one area that we  
5 haven't talked a lot about and you had mentioned, that  
6 I'd like to get a little more information on, is the  
7 invoicing and the royalty payment.

8 In the invoice -- I'll ask questions and let  
9 you respond. But in the invoicing, does that come from  
10 you or the franchisor?

11 And then, secondly, when you get your royalty  
12 payment, is that something that's been agreed up front  
13 with the franchisor as a standard practice, or does that  
14 vary?

15 MS. PHILLIPS: Okay. I'll address your first  
16 question regarding the invoice.

17 Each office that I own is responsible to put  
18 in the hours that the employee has worked at ABC  
19 company, for example. As I put those hours in for John  
20 Doe, that whole process, the back office support, is  
21 actually being processed. It's electronically sent to  
22 them.

23 MR. JACKSON: You initially establish the invoice?

24 MS. PHILLIPS: Correct. The information comes from

25 my office.

152

1 MR. JACKSON: Okay.

2 MS. PHILLIPS: Okay. And then that triggers  
3 everything else. If there is an error, there's an  
4 invoice you have to send out a credit. Hopefully, we  
5 don't have too many of those.

6 what was your second question?

7 MR. JACKSON: The royalty, is that a factor or a  
8 provision that's agreed as part of the franchise  
9 agreement in general, or does it vary by client to  
10 client?

11 Client A, would you experience a different  
12 royalty payment process compared to client B? Again,  
13 how does that royalty figure get established for a  
14 client?

15 MS. PHILLIPS: Prior to signing the agreement with  
16 the franchisor, we understood that there was a  
17 percentage flat across the board. Whether it's a  
18 clerical company or whether it's an industrial company,  
19 it's a flat fee.

20 We were very much aware going into it. We've  
21 done a cost analysis of whether we did it with Express  
22 versus another funding company. And, basically, it was  
23 very cost-effective to go the Express route.

24 MR. JACKSON: Does that pay for all of your  
25 expenses, employee expenses? Is the employee payment

1 from the franchisor or part of the royalty you pay the<sup>153</sup>  
2 employees? The royalty would pay for all of your  
3 expenses, and what's left over would be profit?

4 MS. PHILLIPS: Correct. I believe I understand  
5 your question.

6 MR. JACKSON: The employee salaries and  
7 compensation, is that directly from the franchisor, or  
8 is that part of the royalty payment?

9 MS. PHILLIPS: That is part of what I have  
10 negotiated with the client companies. It's an agreement  
11 from the company that if I supply you with this person,  
12 this is how much you --

13 MR. JACKSON: You're refreshing my memory from  
14 earlier testimony. Okay. That's the right answer.  
15 Okay. Thanks for clarifying.

16 MS. PHILLIPS: Thank you.

17 MR. KLEIN: Thank you.

18 Jeremy Russell?

19 MR. RUSSELL: My name is Jeremy Russell,  
20 J-e-r-e-m-y R-u-s-s-e-l-l, and I'm with the National  
21 Meat Association. Meat, m-e-a-t.

22 Thank you for receiving our testimony today.  
23 On behalf of the National Meat Association, and also the  
24 Southwest Meat Association, which is in Texas, both are  
25 nonprofit industry associations. We represent

1 meatpackers and processors and equipment manufacturers<sup>154</sup>  
2 and food suppliers who provide services to the meat  
3 industry.

4 Many of our members would qualify as small  
5 businesses under any standard you could name. Frankly,  
6 some of these companies, if they got any smaller, they  
7 would probably cease to exist, which underscores the  
8 importance of having a small business designation and  
9 assistance in our industry.

10 I speak for an industry with constant  
11 regulatory uncertainty and increasing consolidation.

12 small businesses in our industry need assistance to  
13 survive and to grow.

14           The situation is such that it has become very  
15 difficult for a small firm to even enter the meat  
16 business, because of prohibitive start-up costs. Not  
17 only are packing plants pricey to build and difficult to  
18 run profitably, but capital investment costs to meet  
19 regulatory requirements are exorbitant, to say the  
20 least.

21           And costly government requirements make it  
22 difficult for these business, which based on customer  
23 demand for ethnic and specialty meats, ought otherwise  
24 to be flourishing.

25           Supermarket sliding fees make it even more

1 difficult for smaller players. Firms already in 155  
2 business are often forced to seek alternative outlets,  
3 such as farmers' markets or the Internet, to get their  
4 products to customers.

5           Fifteen years ago firms might have competed  
6 for Department of Defense meat contracts, but today this  
7 is virtually nonexistent because of new buying systems  
8 used by the government.

9           Still, some firms do sell to the USDA  
10 procurement program, such as the National School Lunch  
11 Program, and some do receive SBA assistance for that.  
12 But actual levels of regulatory restrictions are making  
13 this more difficult.

14           Because programs like the SBA set aside are a  
15 critical component of many small new companies' success,  
16 we laud and support the SBA in its efforts to create a  
17 simplified codification based on number of employees,

18 and offer these comments only to complement and enhance  
19 the SBA's efforts in its advance notice of proposed  
20 ruling.

21           Such a simplified system worked well for the  
22 U.S. Department of Agriculture, and it is one with which  
23 our members, all of them are registered with the USDA  
24 would be familiar and comfortable.

25           A 500-employee-size standard would be

1 appropriate for our industry to determine small business<sup>156</sup>  
2 size. We also support the continuation of a very small  
3 business, VBS, determination as outlined in the  
4 proposal, but with the caveat that it might reach more  
5 businesses in need in our industry if it were worded  
6 slightly differently.

7           For example, USDA, in implementing its past  
8 requirements, developed three phases: a large, small and  
9 very small. Their approach was -- when they published  
10 their ruling in 1996, their approach was to say a very  
11 small business is defined as those with fewer than ten  
12 employees or with annual sales of less than 2.5 million.  
13 It's the "or" I want to emphasize.

14           The SBA VBS program defines small businesses  
15 as one with 15 employees and one million or less in  
16 average annual receipts. And as cumbersome as they  
17 might consider an "or" standard to cast a wider net,  
18 that would read 15 employees or one million or less in  
19 average annual sales.

20           That said, we strongly support the SBA explore  
21 a tiered system for size standards and federal  
22 contracting. And we emphasize that it has been very  
23 successfully implemented by USDA before.

24 Tiered-size standards not only have the  
25 potential to benefit the industry firms, small firms,

1 but they have done so in the past.

157

2 In short, NSMA believes that small businesses  
3 in the meat industry could benefit from the proposals as  
4 outlined in the ANPR, the Advanced Notice of Proposed  
5 Rulemaking, 13 CFR, part 121.

6 Any questions?

7 MR. KLEIN: You talked about the very small 15  
8 employees or a million dollars. How about the general  
9 size standard, where do you see that?

10 MR. RUSSELL: The 500 employee size standard? Yes,  
11 we are. That is the standard, if I'm remembering  
12 correctly, that was used by the USDA, and it was an  
13 appropriate standard for our industry.

14 MR. JACKSON: Just a point of clarification of the  
15 very small business program. Its legislative authority  
16 lapsed, so we no longer have that in effect.

17 But as you are aware, our advance notice did  
18 pass comments on the tiering. So the comments you have,  
19 we will certainly look at very carefully. But I just  
20 want to alert you to that update in the regulation.

21 MR. RUSSELL: Yes, I was aware, and that's why I  
22 wanted to bring that to your attention. We feel that  
23 that would be very beneficial to have such a tiered  
24 system, particularly for the really small.

25 MR. JACKSON: On the tiering system, do you think

1 just using an either/or like the very small business  
2 program had is sufficient, or do you think those levels  
3 should be higher, especially with respect to federal

158



4 procurement?

5 MR. RUSSELL: Possibly a little higher, yeah. I  
6 don't have a firm number to give you right now, but I  
7 could get back to you on that.

8 MR. JACKSON: An earlier person told me I needed to  
9 figure that out. So your answer is consistent. Thank  
10 you.

11 MR. KLEIN: Thanks.

12 MR. RUSSELL: And I have copies of my comments, if  
13 you like.

14 MR. KLEIN: Alex Bangs?

15 MR. BANGS: My name is Alex Bangs, A-l-e-x  
16 B-a-n-g-s. I'm cofounder and chief technology officer  
17 of Entelos, a pharmaceutical company based in Foster  
18 City, California. Appreciate the opportunity to speak  
19 to you today about the SBIR program and the limitations  
20 on funding companies owned by venture investors.

21 Entelos is focused on discovering and  
22 developing new therapies for metabolic and inflammatory  
23 disorders. For example, obesity, diabetes, rheumatoid  
24 arthritis and asthma.

25 Our mission is to leverage our unique

1 predictive capability in human biology to dramatically<sup>159</sup>  
2 improve how medicines are discovered, developed and  
3 brought to market. Using our proprietary PhysioLab  
4 biosimulation platforms, computer-based mathematical  
5 models of human disease, we systematically uncover  
6 biological mechanisms underlying a disease in order to  
7 identify potential points of therapeutic intervention  
8 and the patients most likely to benefit.

9 In addition to our internal research programs,

10 Entelos partners with pharmaceutical and biotechnology  
11 organizations worldwide. Entelos is a member of Bio,  
12 BayBio and the California Healthcare Institute.

13           Regarding our interests in the SBIR program,  
14 we are ineligible to apply, as we understand it, because  
15 we are majority owned by venture investors.

16           Early in our history, before we received any  
17 venture funding, we submitted an SBIR proposal for our  
18 modeling work in asthma. That grant was denied, in  
19 large part, because it was viewed as work that was not  
20 possible.

21           The company is still here today because not  
22 only is it possible, but we've been able to build a  
23 business doing this modeling work and collaborating with  
24 pharmaceutical partners.

25           Today, we broadly contribute to pharmaceutical  
1 R&D, from discovering new targets for diseases, drug 160  
2 targets for diseases, I should say, to designing complex  
3 adaptive clinical trials.

4           Our early work was funded by visionary  
5 pharmaceutical partners and later by our venture  
6 investors.

7           At this stage of the company, we have  
8 developed a core technology platform with opportunities  
9 to extend our R&D in areas that are higher risk and of  
10 less interest to venture investors or pharmaceutical  
11 partners and would be ideal for SBIR grants.

12           For example, we have been asked to model  
13 diseases where there's less data, and the challenge to  
14 create a computer model was either high risk or would  
15 have taken longer than our pharmaceutical partners could

16 tolerate.

17           Entelos had interest in government groups,  
18 including multiple agencies within the NIH, and  
19 nonprofit organizations in having us build models for  
20 other complex diseases. Some of these areas, many of  
21 these areas, such as bio defense and diseases with  
22 smaller patient populations, are of little or no  
23 interest to pharmaceutical companies.

24           Venture investors are also less interested in  
25 these opportunities because they may not be obvious

1 purchasers of products or services at the early stages.<sup>161</sup>

2 In these cases, the SBIR program provides an ideal  
3 funding opportunity to help us bring these products to  
4 market. It is designed to take on high risk but  
5 potential high payoff opportunities, payoff in terms of  
6 revenues, but also benefits for affected patients. Yet  
7 we cannot receive these grants because we are majority  
8 owned by venture capital investors.

9           Another case that leads to an opportunity to  
10 create new products based on our core technology, for  
11 example, in patient care, the same laws that are being  
12 used to understand drug effects for patients for  
13 pharmaceutical R&D can be used to select treatments for  
14 individual patients in a healthcare setting.

15           Again, the payoff for these opportunities is  
16 further out, and it's difficult to seek investors for  
17 this type of development.

18           Yet applying our models and inpatient care  
19 could have significant benefits in getting the right  
20 therapies to the right patients, including healthcare  
21 and lowering costs.

22 Companies like Entelos have the know-how to  
23 undertake very innovative research that can benefit the  
24 American people, however, we do not have additional  
25 capital to undertake risky projects. Venture investors  
1 will undertake some risk, but they have their limits. 162

2 Entelos is a small, innovative business, and  
3 we're ready to take advantage of the SBIR program to  
4 turn our ideas into products. Please give us that  
5 opportunity.

6 Any questions?

7 MR. JACKSON: What's the size of your company?

8 MR. BANGS: We have about 80 employees.

9 MR. JACKSON: And some previous individuals have  
10 testified the VC backing has been from multiple VCs. Do  
11 you have a similar arrangement?

12 MR. BANGS: Yes. We have rights. So ownership of  
13 company is a number of individuals, employees, founders.  
14 There's also a number of venture firms that -- some  
15 U.S., and maybe one or two international.

16 And when I talk about this, I understand that  
17 people are proposing to make the standard U.S.-based  
18 venture firms that have U.S. investors. That makes  
19 obvious sense.

20 We also have some corporate investment, but  
21 it's a very small percentage.

22 MR. JACKSON: In terms of control, how does your  
23 firm operate? Are the founders still in control, do you  
24 feel? How does the VC role play into it?

25 MR. BANGS: There were five founders of the  
1 company. Three of us are still employees. But the CEO 163  
2 is not a founder. The CFO is not a founder. The

3 control of the company is no longer with the founders,  
4 but we are actively members of the executive team.

5 MR. KLEIN: So what exactly is your recommendation  
6 in terms of how you would make VCC ownership available?

7 MR. BANGS: As I understand, I have looked at what  
8 the bio organizations recommended, and they would  
9 propose that firms that are generally venture backed,  
10 that have limited partnership consisting of many  
11 investors that don't have any specific corporate  
12 interests but just have a broad range, should be counted  
13 as individual investors, I believe, or change the  
14 wording so that there would be equivalent of the same.

15 But say, corporate investors, for example, we  
16 have some investors from Pfizer who would not count as  
17 that. So if you're looking for this 51 percent, a  
18 foreign venture firm, a Pfizer, or something like that,  
19 would not count toward the 51 percent. But a firm like  
20 we have Charles River Ventures from Boston or Versant  
21 Ventures, companies like that would count toward the  
22 51 percent.

23 MR. KLEIN: If it was limited in that way, that  
24 would be -- firms would be okay with that, do you think?

25 MR. BANGS: I'm saying for us, we think that's

1 acceptable.

164

2 And speaking personally, you know, I  
3 understand the goal here is to find -- you know, you  
4 want to go for small businesses, and so people that are  
5 largely invested in a large corporate entity, I think,  
6 wouldn't necessarily make sense. Firms that have a  
7 large foreign investment doesn't necessarily make sense.  
8 So I can agree with that.

9 MR. KLEIN: Thank you.  
10 Chris Whittington?  
11 MR. WHITTINGTON: Good afternoon. My name is Chris  
12 Whittington. That's spelled C-h-r-i-s  
13 w-h-i-t-t-i-n-g-t-o-n. I'm here representing GC Micro,  
14 Corporation. We actually have been recognized, on  
15 numerous occasions, by the administrator's award of  
16 excellence from the SBA. I'd like to thank you for  
17 hearing our testimony.

18 We're very concerned about the small business  
19 size standards. In 2002, the GAO launched an  
20 investigation, based on information provided by the GAO  
21 SBA president, Lloyd Chapman.

22 The GAO found billions in small business  
23 contracts had been awarded to large businesses. The SBA  
24 was forced to remove the names of over 600 of the  
25 nation's largest firms from PRO-Net, their small

1 business database. Firms such as Nike, AT&T, Hilton 165  
2 Hotels, Office Max and Office Depot were listed as small  
3 businesses.

4 In September of 2004, the Center for Public  
5 Integrity found the Defense Department alone had awarded  
6 over \$47 billion in small business contracts to many of  
7 the nation's top defense contractors.

8 The SBA's own inspector general has recently  
9 released the results of three investigations that found  
10 the SBA was reporting awards to large businesses as  
11 small business awards.

12 Report 515 states that one of the most  
13 important challenges facing the SBA and the entire  
14 federal government today is that large businesses are

15 receiving small business procurement awards, and  
16 agencies are receiving credit for these awards.

17 I believe the SBA plans to use the tiered  
18 systems to triple the current small business size  
19 standard for most government purchasing from 500  
20 employees to 1,500.

21 U.S. Census Bureau statistics show that  
22 89 percent of all U.S. firms have less than 20  
23 employees, and the average American firm has  
24 approximately 12 employees. The small business size  
25 standard of 1,500 will be more than 100 times greater

166

1 than the average American company.

2 GC Micro is against grandfathering. The SBA  
3 grandfathering plan will divert billions in small  
4 business contracts to large businesses, and allow these  
5 blatant abuses to continue for up to five years.

6 98 percent of all American firms have less  
7 than 100 employees. These are the firms Congress  
8 intended to benefit from the Small Business Act. These  
9 are the firms where most Americans are employed and  
10 where most of our nation's tax revenue is collected.

11 These true American small businesses do not  
12 want or need grandfathering, a tiered system, or  
13 exclusions from the affiliation rule for venture capital  
14 companies.

15 The SBA's plan to provide an exclusion from  
16 affiliation for venture capital companies in size  
17 determinations will allow the SBA to report awards to  
18 multi-billion-dollar banks, investment firms or other  
19 large businesses as small business awards.

20 GC Micro wants an end to fabricated small

21 business statistics. We want annual recertification, a  
22 100-employee size standard for wholesale trade, and we  
23 want the SBA to immediately adopt all recommendations of  
24 the SBA Inspector General to end fraud and  
25 misrepresentation in federal small business contracting.

167  
1 The SBA's own office of advocacy found the SBA  
2 had reported contracts to corporate giants like  
3 Raytheon, Northrup, Titan, VAG Systems, Perot Systems,  
4 Carlyle Group, General Dynamics, EDS, Archer Daniels  
5 Midland, ITT Industries, SAIC, Oracle and  
6 Hewlett-Packard as awards to small businesses.

7 The SBA reported \$98 million in contracts to  
8 Burma, a Dutch firm, with 18,000 employees worldwide as  
9 awards to small business.

10 Changing size standards won't make any  
11 difference if the SBA doesn't aggressively enforce the  
12 small business program.

13 And that's the end of my comments.

14 MR. KLEIN: Obviously, we've heard this issue  
15 before. Again, we -- well, first of all, when you say  
16 you're against grandfathering, what does grandfathering  
17 mean in your mind?

18 MR. WHITTINGTON: Grandfathering would be for any  
19 business who had established a contract to -- if the  
20 business established a small business contract to retain  
21 that small business size throughout the remainder of the  
22 contract.

23 MR. KLEIN: Under the proposal that was -- well,  
24 the March 2004 proposal, which would propose to change  
25 the size standards from annual receipts to employees, in



1 doing that process, certain firms would have lost their  
2 size status as small merely by the fact that it would  
3 change from revenue to employees, even though the intent  
4 of the change was to make it simpler and not affect size  
5 status.

6 Grandfathering meant those firms which were  
7 adversely affected by that change, even though we didn't  
8 intend to change the size, would have been adversely  
9 changed from small to other than small merely because of  
10 the crossover to employees.

11 For those firms, what you're saying is you  
12 would want it to apply immediately without any rollback  
13 or with any transition period? Is that what you're  
14 saying?

15 MR. WHITTINGTON: No. I'm making comments on what  
16 I saw in the Federal Register. That's confusing for me.

17 MR. QUINN: Could I ask a question on that as well?  
18 I mean, it seems like grandfathering has been understood  
19 to mean three different things.

20 MR. KLEIN: That's why I'm trying to understand  
21 what he is against.

22 MR. QUINN: Right. But I mean, the way we are  
23 talking about grandfathering could mean when the size  
24 standards change from revenue to employees to  
25 grandfathered, they're continuing, when the business

169  
1 grows from small to large, to talk about grandfathering,  
2 if they are still working on a contract, or if they are  
3 acquired by somebody as a large corporation to be  
4 grandfathered in on that contract.

5 So I guess maybe the point here is the  
6 definition of grandfathering is misunderstood by me and

7 others.

8 MR. KLEIN: Well, we would accept comments on any  
9 of those issues. I'm just trying to understand what you  
10 were talking about.

11 MR. WHITTINGTON: I understand.

12 MR. JACKSON: Just to clarify, I think John  
13 described what our intention was, that the March 2004  
14 proposal that we received comment on, one of the main  
15 concerns was the loss of small business eligibility when  
16 firms are currently small. And we try to have a neutral  
17 impact. We've found that it's very difficult to make  
18 that transition between averaging receipts to number of  
19 employees. There's a lot more variation within an  
20 industry than what we realized in some cases.

21 And in other cases, we just have a different  
22 business operation. So the concern expressed to us was  
23 just to allow companies that are currently small to have  
24 some period to adjust.

25 we heard testimony earlier today that one

1 company felt that he couldn't manage receipts but he 170  
2 could manage employees. If we went to number of  
3 employees, if a company was 55 employees and the size  
4 standard we proposed or adopted was 55, a company would  
5 have some period to adjust to that 50-employee level in  
6 recognition that it currently has less than \$6 million  
7 in receipts from what the previous standard was.

8 I think Mark's right that when we talk about  
9 grandfathering in general, it's hard to put your hands  
10 on all the ideas, but we're more focused on if we move  
11 towards simplification or some type of restructuring, we  
12 don't want it to have an adverse impact on companies as

13 a result of that.

14 That would be different than changing size  
15 standards where we would go into an industry review,  
16 make a change, and we're saying based on that analysis  
17 here is what small business is.

18 Just one comment. You mentioned we were  
19 considering 1,500 employees. I would like to clarify,  
20 there have been some commenters suggested that level.  
21 Even today we've had some groups advocate that. In  
22 prior hearings we've had more. You know, it's part of  
23 the testimony that we will consider along with your  
24 recommendation for a hundred employees.

25 But 98 percent of the firms practically are  
1 small businesses. And, in fact, within that statistic,<sup>171</sup>  
2 you have a large proportion that's merely a handful of  
3 employees; and among those groups, you have a lot of  
4 turnover within a year or so of business activity.

5 What does that statistic tell us that compels  
6 you that you think that's a good small business  
7 definition?

8 SBA currently looks at a variety of factors,  
9 average firm size, market share, entry cost and so  
10 forth. What do you think that the 98 percent, what does  
11 that reveal, that compels you to recommend that SBA  
12 should limit its review to just that consideration in  
13 selecting size standard?

14 MR. WHITTINGTON: We strongly believe that SBA size  
15 standards should be looked upon over a broad industry.  
16 We are a part of the IT wholesale trade industry, and we  
17 are the only classification in that broad spectrum that  
18 has 500 employees or less small business, where

19 everybody else is 100 or less. So we very strongly  
20 believe that that should be reviewed.

21 MR. JACKSON: Okay. So is your hundred employee  
22 limited to the wholesale trade category, distributors,  
23 resellers, or are you looking across the board?

24 MR. WHITTINGTON: We're looking across the board.

25 MR. JACKSON: Okay. Thank you.

172

1 MR. KLEIN: Cecilia Zamora?

2 That's the list. I will try it one more time.  
3 Is there anyone here left who would still like to speak?

4 MS. GUADARRAMA: Actually, if I could speak for a  
5 moment -- I'm with GC Micro -- with the broader idea of  
6 what you were asking about on the size standards. May I  
7 do that for a moment?

8 MR. KLEIN: Are you on schedule tomorrow?

9 MS. GUADARRAMA: It was to clarify the question  
10 that Gary was actually --

11 MR. JACKSON: To clarify a question, yeah, we'll  
12 allow that.

13 MS. GUADARRAMA: When we're talking about the  
14 100-employee size standard, we are specifically looking  
15 at the IT wholesale industry.

16 In terms of actually trying to take any of  
17 these one-size standards and put it across all the small  
18 businesses, I don't actually think that that's -- that  
19 that's doable.

20 I really think the more appropriate way of  
21 looking at it would be industry by industry, as opposed  
22 to trying to say small business as a group, and come up  
23 with a size standard for small businesses. You're going  
24 to have a huge difference between IT wholesalers, the

25 R&D industry that's out there, manufacturers that are

173

1 out there.

2           So I think from my experience in speaking with  
3 a number of small businesses, part of the problem that  
4 we're running into is trying to come up with a  
5 definition for you, where we're looking at such a broad  
6 scope that we're trying to cover, as opposed to if you  
7 ask me specifically about my industry, I could give you  
8 all kinds of statistics, as opposed to trying to come up  
9 with a set of standards across the board for all small  
10 businesses.

11           I think that's -- you're asking us to kind of  
12 put our arms around this huge, huge entity that we're  
13 all finding very difficult to do.

14           MR. KLEIN: Every commenter wants to specify their  
15 industry. That makes sense. That's their knowledge and  
16 that's appropriate. We have no problem with that.

17           MR. JACKSON: In fact, we didn't discuss this in  
18 the ANPRN.

19           Just to let you know where we are in the  
20 process, we have broken out the nonmanufacturer size  
21 standard that applies to wholesalers and distributors  
22 selling products to the federal government as a separate  
23 analysis. We've done quite a bit of analysis. It's on  
24 my desk for review.

25           So among the things that I need to work on

1 when I get back to Washington next week, that's one of<sup>174</sup>  
2 the top things. So I expect that we'll propose  
3 something later this year. And we certainly want to  
4 make you aware of that, and look forward to your  
5 comment.

6           we can't divulge anything about the analysis  
7 at this point, other than to acknowledge yes, we agree  
8 we need to revisit that, look at our traditional  
9 methodology. Our traditional methodology is not a fixed  
10 one. And we look at certain standard factors. But we  
11 have the ability to factor in other relevant  
12 considerations, and that's one of the most important  
13 parts of public comment.

14           And like John said, we know your industry. We  
15 work with the industries. We talk with people. We try  
16 to learn things quickly. We look at a lot of statistics  
17 and try to make decisions.

18           But the comments play a vital part in the  
19 process. And over time we've adjusted our proposed  
20 standards, based on our standard analytical approach,  
21 both higher and lower from what we've proposed.

22           So again, hopefully we'll have a chance to  
23 look at that issue specifically later this year, and be  
24 happy to work with you once that proposal is out.

25           MS. GUADARRAMA: Wonderful. Thank you.

1           MR. KLEIN: At this point, I guess we're done. 175  
2 There will be one more hearing tomorrow, in Los Angeles,  
3 and after that we will compile all of the testimony and  
4 review and determine what proposals to make in the  
5 future.

6           Obviously, any proposals we make will be  
7 published in the Federal Register, and there will be  
8 more opportunity to comment at that point in time.

9           Thank you.

10

11

12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

176

1 STATE OF CALIFORNIA            )  
2                                        )     ss  
3 COUNTY OF SAN MATEO            )

4  
5           I hereby certify that the foregoing transcript  
6 of proceedings was by me taken at the time and place  
7 herein named; that the transcript is a true record of  
8 the proceedings as reported by me to the best of my  
9 ability under the parameters of a public hearing; that I  
10 am a duly certified shorthand reporter and a  
11 disinterested person; and that the proceedings were  
12 thereafter transcribed into typewriting by computer.

13           I further certify that I am not interested in  
14 the outcome of the said action, nor connected with, nor  
15 related to any of the parties in said action.

16           IN WITNESS WHEREOF, I have hereunto set my  
17 hand this 11th day of July, 2005.

SanFrancisco.txt

18

19

20

- - - - -  
KATHERINE A. POWELL, CSR #5812

21

STATE OF CALIFORNIA

22

23

24

25

177